

June 30, 2020

New York Proposes Conditional BitLicense

Conditional License Framework Would Allow Entities Without a BitLicense to Engage in Virtual Currency Business Activity in Collaboration with BitLicensees; NYDFS Requests Public Comments

SUMMARY

On June 24, 2020, the New York State Department of Financial Services (“NYDFS”) proposed a framework to authorize entities without a BitLicense or a trust company charter to engage in virtual currency business activities in New York under a conditional license (the “Proposed Framework”). The Proposed Framework would allow these entities to engage in virtual currency business activity in collaboration with an authorized BitLicensee or a holder of a New York limited purpose trust charter (each, a “Fully Licensed Entity”). Under the Proposed Framework, such conditionally licensed entities (“Conditional Licensees”) would engage with Fully Licensed Entities to receive services and support, such as those relating to structure, capital, systems or personnel. NYDFS expects that a Conditional Licensee will endeavor to eventually seek and obtain a full BitLicense. NYDFS has requested comments on the Proposed Framework by August 10, 2020.

PROPOSED CONDITIONAL LICENSING FRAMEWORK

In June 2015, NYDFS issued its virtual currency regulation, 23 NYCRR Part 200 (the “BitLicense Regulation”). The BitLicense Regulation requires all entities engaging in a broad variety of virtual currency business activity involving New York or New York residents to first obtain a license (often referred to as a “BitLicense”) from NYDFS. In order to obtain a BitLicense, entities must undergo a rigorous application process and meet requirements for governance, compliance and capital, among other things. Since June 2015, NYDFS has granted 25 BitLicenses and limited purpose trust charters with authority to engage in virtual currency activities.¹ The BitLicense Regulation also provides that, in the sole discretion of the NYDFS superintendent, a conditional license with tailored requirements may be issued to an applicant that

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“does not satisfy all of the regulatory requirements” of the BitLicense Regulation.² However, NYDFS did not disclose the factors that it would consider in granting a conditional license.³

The Proposed Framework would permit firms without a full BitLicense to engage in virtual currency business activity in collaboration with Fully Licensed Entities during the term of a conditional license. The purpose of the Proposed Framework, as stated by NYDFS, is to encourage startups, growth-stage companies, established New York companies, and established virtual currency companies not operating within New York to “locate, operate, employ, grow, remain, and expand in New York State.”⁴ NYDFS noted that the Proposed Framework would help firms overcome “actual or perceived hurdles” faced in obtaining a BitLicense.⁵

NYDFS stated that the Proposed Framework would establish the following general process:

- An applicant intending to become a Conditional Licensee will contact NYDFS to indicate its intention to enter into an arrangement to collaborate with a specific Fully Licensed Entity and seek to begin the application process by providing a draft of a service level or similar agreement (the “SLA”) between the applicant and the Fully Licensed Entity, with the understanding that entry into an SLA, or any other agreement, with a Fully Licensed Entity is not, in itself, sufficient for NYDFS to grant the conditional license.
- The applicant will be required to submit certain documents and information, based on, for example, the type of business the applicant expects to conduct, and the risks presented by that business.
- Once an applicant submits all required information and documentation and NYDFS finds those materials to be informationally complete, NYDFS will begin its substantive review.
- Consistent with NYDFS’s standard practice, NYDFS and the applicant will enter into a supervisory agreement, which will detail, among other things, the activities in which the applicant may engage, the requirements it must meet, the division, apportionment and sharing of responsibilities and liabilities with the Fully Licensed Entity, and the oversight NYDFS will conduct with respect to the applicant. An applicant may be subject to heightened review, including through examination.
- If NYDFS approves the application, it will issue to the applicant a conditional license under the BitLicense Regulation. Once licensed, the Conditional Licensee may engage in any virtual currency business activity, as approved by NYDFS.

NYDFS also requested comments from interested parties and the general public regarding the Proposed Framework and the general process set forth above, specifically requesting input regarding the following questions:

- What types or categories of Conditional Licensees would be most suitable and benefit most from the Proposed Framework, including the characteristics and requirements, such as those relating to size, business model, potential impact on innovation and the New York financial markets, revenue, customer base, experience, management, and operational history of the Conditional Licensees?
- What types or categories of Fully Licensed Entities would be most suitable, and what characteristics and requirements, such as those relating to size, expertise, corporate

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governance, controls, compliance, operational capacity, and supervisory experience, should they satisfy in order to effectively and safely work in collaboration with a Conditional Licensee?

- What types of services and support should a Fully Licensed Entity provide to a Conditional Licensee with the ultimate goal of enabling the Conditional Licensee to obtain a full BitLicense from NYDFS?
- What limits should be placed on the types and levels of services and support a Fully Licensed Entity may provide to a Conditional Licensee, including capital infusion, guarantees, day-to-day management and operations, board representation, policy making decisions, and control of the Conditional Licensee?
- How should a Fully Licensed Entity ensure that its own safety and soundness, including operations, controls, and compliance with its supervisory agreement would not be adversely impacted by these collaborative arrangements, including caps and limits on the total number of such arrangements for the Fully Licensed Entity?
- What initial due diligence should a Fully Licensed Entity conduct on a Conditional Licensee, and what initial due diligence should such a Conditional Licensee conduct on the Fully Licensed Entity before the two entities start collaborating under this framework?
- What ongoing due diligence should a Fully Licensed Entity conduct on a Conditional Licensee, and what ongoing due diligence should the Conditional Licensee conduct on the Fully Licensed Entity (including, in each case, the frequency of such due diligence) in order to assess their continued collaboration under this framework?
- What would be the most appropriate way to divide, apportion, and share responsibilities, obligations, and liabilities between a Fully Licensed Entity and a Conditional Licensee? For example, how should the responsibility or liability associated with any potential failure to meet statutory, regulatory, or other obligations be divided, apportioned, or shared, and what should be the mechanics for achieving that?
- How should a Fully Licensed Entity and a Conditional Licensee ensure that any conflicts of interest that may exist between them are identified and effectively addressed, and what should be the mechanics for achieving that?
- How should a Fully Licensed Entity and a Conditional Licensee's collaboration be structured to mitigate the risk of an adverse impact on markets as a result of such joint effort and collaboration?
- In addition to the proposed framework, what other methods might NYDFS consider to safely and effectively facilitate entry and growth into New York's virtual currency marketplace?

NYDFS requested comments be submitted by August 10, 2020.

OTHER ACTIONS

The Proposed Framework was one of a series of NYDFS actions on virtual currency announced on June 24, 2020. NYDFS also announced that it had entered into a Memorandum of Understanding ("MOU") with the State University of New York ("SUNY") concerning a virtual currency program.⁶ Pursuant to the MOU, SUNY will establish a Fully Licensed Entity authorized by NYDFS to conduct virtual currency business activity in New York. The SUNY Fully Licensed Entity will provide services and support (such as with respect to structure, capital, systems, or personnel) to Conditional Licensees. The SUNY initiative is intended to assist start-ups and emerging companies in applying for a conditional license and to expand

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opportunities to new geographies and demographics throughout the state. NYDFS will in turn “foster and encourage open communication” with SUNY, applicants, the Fully Licensed Entity, and Conditional Licensees.⁷

NYDFS also issued final guidance regarding BitLicensees’ ability to self-certify the use and listing of new virtual currencies⁸ and announced that it is issuing additional virtual currency-related resources, including a notice of NYDFS practices aimed at creating a more transparent and timely process for the evaluation of virtual currency license applications and new virtual currency-related Frequently Asked Questions.⁹ NYDFS stated that these initiatives, announced five years after the introduction of the BitLicense Regulation, are the result of significant outreach to industry and other experts in the field regarding feedback on Fully Licensed Entities’ experiences with DFS and ideas intended to facilitate their successful operation in New York.¹⁰

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ENDNOTES

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- ¹ Guidance Regarding Adoption or Listing of Virtual Currencies, *available at* https://www.dfs.ny.gov/apps_and_licensing/virtual_currency_businesses/gn/adoption_listing_vc.
 - ² 23 NYCRR § 200.4(c).
 - ³ *Id.*
 - ⁴ Request for Comments on a Proposed Framework for a Conditional BitLicense (June 24, 2020), *available at* https://www.dfs.ny.gov/apps_and_licensing/virtual_currency_businesses/gn/req_comments_prop_framework; see N.Y. Fin. Serv. Law § 102(a).
 - ⁵ *Id.*
 - ⁶ See Memorandum of Understanding between the New York Department of Financial Services and The State University of New York (June 18, 2020), *available at* https://www.dfs.ny.gov/system/files/documents/2020/06/mou_dfs_suny_20200618.pdf.
 - ⁷ *Id.*
 - ⁸ See Guidance Regarding Adoption or Listing of Virtual Currencies, *available at* https://www.dfs.ny.gov/apps_and_licensing/virtual_currency_businesses/gn/adoption_listing_vc.
 - ⁹ See Notice of Virtual Currency Business Activity License Application Procedures, *available at* https://www.dfs.ny.gov/apps_and_licensing/virtual_currency_businesses/gn/notice_vc_busact_license_app_procedure; BitLicense FAQs, *available at* https://www.dfs.ny.gov/apps_and_licensing/virtual_currency_businesses/bitlicense_faqs.
 - ¹⁰ DFS Superintendent Lacewell Launches Series of Virtual Currency Initiatives (June 24, 2020), *available at* https://www.dfs.ny.gov/reports_and_publications/press_releases/pr202006241.

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