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Illinois Department of Financial & Professional Regulation
100 W. Randolph St., Floor 9
Chicago, Illinois 60601-3218

Re: Digital Currency Regulatory Guidance

To whom it concerns at the IDFPR:

I am the principal attorney of Fornaro Law, a law firm with offices in La Grange and Hinsdale, Illinois that provides legal services to clients who reside in Illinois and/or do business in Illinois. I and several of my colleagues have read the full text of the IDFPR's proposed "Digital Currency Regulatory Guidance" (hereinafter referred to simply as the "Guidance"). Because several of Fornaro Law's clients either have established, or are contemplating establishing, businesses involving the sale of digital currency to customers, we wanted to provide the IDFPR with a comment concerning the Digital Currency Regulatory Guidance. This comment expresses views that are not necessarily synonymous with those of all of our clients on this subject matter. Accordingly, this comment should be considered the comment of Fornaro Law only, and should not be attributed to any one or more of its clients.

We commend the IDFPR for the explicit recognition set forth in the Guidance that digital currency should not be considered "money" within the meaning of the Illinois Transmitters of Money Act ("TOMA"), as it is consistent with an emerging consensus among numerous federal and state agencies that digital currency is property and not money.

For example, such an approach is consistent with the approach that the Federal Internal Revenue Service has taken for several years. IRS Notice 2014-21 makes clear that digital currency, for Federal tax purposes, is treated as property. As such, "[g]eneral tax principles applicable to property transactions apply to transactions using virtual currency." (IRS Notice 2014-21, at 2.)

Such an approach is also consistent with the approach that the U.S. Commodity Futures Trading Commission ("CFTC") has been taking for well over a year. In an order issued on September 17, 2015, the CFTC held that Bitcoin and other digital currencies are commodities covered by the Commodity Exchange Act ("CEA"). (*See* September 15, 2015 Order Instituting

Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, Making Findings and Imposing Remedial Sanctions, *In re Coinflip, Inc., d/b/a Derivabit, and Francisco Riordan*, CFTC Docket No. 15-29; *see also* Release pr7231-15, available at: http://www.cftc.gov/PressRoom/PressReleases /pr7231-15.)

A Florida court has also recently determined that digital currency is not "money" within the confines of Florida's legal system. (*See Florida v. Espinoza*, Case No. F14-2923, Circuit Court of the Eleventh Judicial Circuit in and for Miami-Dade County, Florida, July 22, 2016.) Specifically, on July 22, 2016, a Miami judge dismissed charges against a Florida-based Bitcoin seller. (*Espinoza* at 8.) The State contended, among other things, that the Bitcoin seller was operating as an unlicensed money services business. (*Espinoza* at 4.) Finding that the profit derived from selling Bitcoin at a higher price than the price he paid for it was not a "transmission fee," the court disagreed, holding that the sale of Bitcoin for profit did not constitute a money services business for many different reasons. (*Espinoza* at 6.) The court's own language and reasoning is instructive:

> Bitcoin may have some attributes in common with what we commonly refer to as money, but differ in many important aspects. While Bitcoin can be exchanged for items of value, they are not a commonly used means of exchange. They are accepted by some but not by all merchants or service providers. The value of Bitcoin fluctuates wildly and has been estimated to be eighteen times greater than the U.S. dollar. Their high volatility is explained by scholars as due to their insufficient liquidity, the uncertainty of future value, and the lack of a stabilization mechanism. With such volatility they have a limited ability to act as a store of value, another important attribute of money.
>
> Bitcoin is a decentralized system. It does not have any central authority, such as a central reserve, and Bitcoins are not backed by anything. They certainly are not tangible wealth and cannot be hidden under a mattress like cash and gold bars.
>
> This Court is not an expert in economics, however, it is very clear, even to someone with limited knowledge in the area, that Bitcoin has a long way to go before it is the equivalent of money.

(*Espinoza* at 5-6.)

The approach taken by the IRS, the CFTC and the Florida court in the *Espinoza* case – of treating digital currency as property, not money – is also consistent with the approach that the Texas Department of Banking has been following since 2014. In Supervisory Memorandum – 1037, issued on April 3, 2014, the Texas Department of Banking concludes that the exchange of digital currency (described in the memorandum as "cryptocurrency") in any manner, whether for sovereign currency or any other type of property, is not money transmission because digital

currency does not fall within the definition of "currency" used for purposes of the Texas Money Services Act.

The IDFPR Guidance, having explicitly stated that digital currency is not "money," falls short, however, when it comes to analyzing digital currency transactions that involve third parties. According to the Guidance, whether a given transaction involving digital currency requires TOMA licensure depends on how the transaction in which it is used is organized.

Unfortunately, the Guidance interpretation does not provide for any circumstance in which a digital currency can be brokered in exchange for sovereign currency by a third party intermediary without that third party being required to obtain a TOMA license. This approach conflicts with the approach taken by the Texas Department of Banking which, as noted, like the IDFPR, does not view digital currency as "money."

The Texas Department of Banking's approach stems from its interpretation of the definition of "currency" used for purposes of the Texas Money Services Act: "the coin and paper money of the United States or any country that is designated as legal tender and circulates and is customarily used and accepted as a medium of exchange in the country of issuance." (Texas Finance Code §151.501(b)(1).)

That definition bears striking similarity to the definition of "[m]oney" in Section 5 of the Illinois TOMA: "[A] medium of exchange that is authorized or adopted by a domestic or foreign government as part of its currency and that is customarily used and accepted as a medium of exchange in the country of issuance."

Yet, despite the similarity in definitions of "money" between the Illinois TOMA and the Texas Money Services Act, the Texas Department of Banking concludes that "no currency exchange license is required in Texas to conduct any type of transaction exchanging virtual with sovereign currencies." (Tex. Dept. Banking Supervisory Memorandum – 1037 at 2.) The point of departure between the differing approaches outlined by Illinois and Texas is the practical effect of the failure of the respective statutory definitions of "money" to include digital currency within their purview. For the Texas Department of Banking, ". . . money transmission licensing determinations regarding transactions with cryptocurrency turn on the single question of whether cryptocurrencies should be considered 'money or monetary value' under the Money Services Act." (Tex. Dept. Banking Supervisory Memorandum – 1037 at 3.) Because, under the Texas licensing statute 'money or monetary value' requires either "currency" or "a claim that can be converted into currency," the inquiry ends when it is determined that digital currency is not "currency."

Not so with the IDFPR's inquiry, and this is puzzling to us – particularly given the striking similarity in the definition of money utilized by the licensing statutes of the two states. Despite the IDFPR's recognition that digital currency is not money, the IDFPR in the Guidance nevertheless imposes upon any person or business desirous of brokering an exchange of digital currency for sovereign currency the obligation of obtaining a TOMA license.

To our knowledge, no TOMA license is required of a person brokering artwork between a seller and a buyer. Nor is a TOMA license required of a person brokering a business, livestock, grain, seeds, or even used vehicles. While some of the examples mentioned require licensure by other Illinois departments, such as the Department of Agriculture, the Illinois Secretary of State Dealer Licensing Department or the Illinois Secretary of State Securities Department, the Guidance fails to offer sufficient justification for considering a third-party broker of something explicitly acknowledged not to be "money" in exchange for sovereign currency to constitute a "money transmitter" within the meaning of TOMA.

Even FinCEN's longstanding guidance on what constitutes the transmission of money states that as long as a broker or dealer in real currency or other commodities accepts and transmits funds solely for the purpose of effecting a *bona fide* purchase or sale of the real currency or other commodities for or with a customer, such person is not acting as a money transmitter under the regulations. (*See Application of the Definition of Money Transmitter to Brokers and Dealers in Currency and other Commodities*, FIN-2008-G008, Sept. 10, 2008.)

We believe the Guidance falls short in this area by failing to include a similar exception. If digital currency is truly property, and not money, as the Guidance explicitly acknowledges, then it is regulatory overreach to consider someone acting as a third-party broker of that property a "money transmitter" and require that person to obtain a TOMA license. We acknowledge that a person acting as a third-party broker in such a capacity may need to be licensed in some way by the State of Illinois. But classifying such a person as a money transmitter seems akin to trying to fit a square peg in a round hole.

Simply put, there is no compelling reason to consider the broker in a straightforward brokerage deal involving digital currency a "money transmitter." That was the conclusion reached by both the Texas Department of Banking and FinCEN. The IDFPR should reach this same conclusion and revise the Guidance accordingly.

There is always risk associated with applying laws written decades ago to new technologies – such as digital currency. The risk of stifling innovation or hurting the entrepreneurial spirit is a considerable one. The prospect posed by the Guidance as presently written is that businesses which deal in digital currency in Illinois will be subject to disparate regulatory treatment, needing to account for it as property for federal tax accounting or CEA compliance purposes but to also comply with the licensure requirements of a regulatory regime adopted decades ago for activity that bears little to no resemblance to the activities such requirements were originally intended to regulate. Treating a third-party broker of digital currency as a "money transmitter" will artificially inflate the cost of doing business in Illinois for those businesses which either presently deal in digital currency or desire to do so. It risks driving such businesses away from Illinois and into other states – such as Texas – where digital currency faces less regulatory uncertainty or overreach.

The IDFPR should exercise caution before implementing an approach that risks diverting useful tax revenue from income generated by this emerging market into other states where the regulatory environment is more hospitable to it. In our opinion, the IDFPR should

spend more time observing this emerging market before concluding that the Illinois Transmitters of Money Act is the most appropriate regulatory framework by which to regulate the use of digital currency. At the very least, the Guidance should be revised to make clear that a third party intermediary acting solely as a broker on behalf of a digital currency seller is not acting as a "money transmitter" within the meaning of that act.

We thank the IDFPR for the opportunity to provide this comment on its proposed Digital Currency Regulatory Guidance.

Very truly yours,

/s/

Philip M. Fornaro