



ILLINOIS DEPARTMENT OF FINANCIAL AND PROFESSIONAL
REGULATION (IDFPR): REQUEST FOR COMMENT

DIGITAL CURRENCY REGULATORY GUIDANCE

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Purpose

Digital currencies such as Bitcoin, Dogecoin, Ethereum, Litecoin, and ZCash have raised questions with respect to money transmission and exchange of currency. This guidance outlines the policy of the Illinois Department of Financial and Professional Regulation (the “Department”) with regards to digital currencies. This guidance expresses the Department's interpretation of Illinois’ Transmitters of Money Act,¹ (“TOMA”) and its application to various activities involving digital currencies. This guidance seeks to establish the regulatory treatment of digital currencies under TOMA as it currently exists.

Types of Digital Currency

In short, a digital currency is an electronic medium of exchange used to purchase goods and services. A digital currency may also be exchanged for sovereign currency.² A digital currency, by nature of its properties detailed below, is distinct from other forms of sovereign currency.

Legal Tender vs. Non-Legal Tender:

As of the date of this regulatory guidance, the Department is not aware of any jurisdiction in which digital currency has status as legal tender or of any digital currency issued by a government’s central bank. As such, digital currencies exist outside the recognition of established financial institutions.

Centralized vs. Decentralized:

There are generally two basic types of digital currencies: *centralized* and *decentralized*. ***Centralized digital currencies*** are created and issued by a specified source. They rely on a person or entity with authority or control over the currency. Typically, the person or entity exercising authority or control over the centralized digital currency is also the creator of that currency.

In addition to the two types of centralized digital currency, there are numerous sub-classifications. Centralized digital currencies can be *non-convertible* meaning they can be purchased with sovereign currency, but cannot be exchanged back to sovereign currency. Centralized digital currencies can also be *convertible* meaning they can be converted back to sovereign currency. Additionally, some centralized digital currencies can be used only for

¹ Illinois Compiled Statutes (205 ILCS 657/1, *et seq.*)

² In this guidance the term sovereign currency will be used to mean government-issued currencies with legal tender status in the country of issuance. In most literature pertaining to digital currency, the term fiat currency is used to refer to government-issued legal tender.

purchase of goods and services from a closed universe of merchants, are specific to a particular virtual domain or world,³ or have a theoretically open universe of merchants.

Decentralized digital currencies are not created or issued by a particular person or entity, have no administrator, and have no central repository. Although decentralized digital currency is not classified as a legal tender, it is convertible, meaning it has equivalent value in sovereign currency and can be exchanged to or for sovereign currency. Most, but not all, decentralized digital currencies are also cryptocurrencies. These include Bitcoin, Litecoin, Peercoin, Namecoin, Ether, etc. A cryptocurrency is based on a cryptographic protocol that manages the creation of new units of the currency on a shared ledger through a peer-to-peer network. Cryptocurrency is created through a process called mining performed by the “miner.” Mining involves running an application on a computer that performs consensus algorithm calculations such as proof-work or proof-of-stake. When the computer performs a sufficient amount of these calculations, the cryptocurrency's underlying protocol generates a new unit of the currency which can be delivered to the miner's wallet. Because users' wallets act as the connection points of the digital currency's decentralized peer-to-peer network, transfers of digital currency are made directly from wallet to wallet, whereas transmissions of sovereign currencies must be made through one or more intermediaries such as a financial institution or money transmitter.

One differentiating characteristic of decentralized and centralized digital currency is that while centralized digital currency can have intrinsic value through backing by sovereign currency or precious metals, decentralized currency lacks intrinsic value. A unit of decentralized digital currency does not represent a claim on a commodity, and is not convertible by law. Its value is only what a buyer is willing to pay for it.

Most decentralized digital currencies are traded on third party exchange sites where the exchange rates with sovereign currencies are determined by averaging the transactions that occur. Decentralized digital currency can also be considered a new asset class that is neither currency nor commodity.

³ The term “virtual currency” commonly used by other governmental bodies can be used interchangeably with the term “digital currency” throughout this guidance document.

Application of Transmitters of Money Act

This guidance does not address money transmission activities involving the centralized digital currencies schemes in existence. As such, businesses engaging in activities that may be considered money transmission involving centralized digital currency schemes should seek an individual licensing determination from the Department.

This guidance is focused on money transmission activities involving decentralized digital currencies. Whether or not an Illinois money transmitter license is required for an entity to engage in the transmission of decentralized digital currencies turns on the question of whether decentralized digital currency is considered "money" as defined in TOMA. Accordingly, Section 5 of TOMA defines a "[m]oney transmitter" as:

[A] person who is located in or doing business in this State and who directly or through authorized sellers does any of the following in this State:

- 1) Sells or issues payment instruments***
- 2) Engages in the business of receiving money for transmission or transmitting money.***
- 3) Engages in the business of exchanging, for compensation, money of the United States Government or a foreign government to or from money of another government.***

Furthermore, Section 5 of TOMA defines the action of "[t]ransmitting money" as:

[T]ransmission of money by any means, including transmissions to or from locations within the United States or to and from locations outside of the United States by payment instrument, facsimile or electronic transfer, or otherwise, and includes bill payment services.

Section 5 of TOMA defines "[m]oney" as:

[A] medium of exchange that is authorized or adopted by a domestic or foreign government as a part of its currency and that is customarily used and accepted as a medium of exchange in the country of issuance.

Accordingly, although decentralized digital currencies are a representation of value that can function as a medium of exchange, they are not considered "money" for the purposes of TOMA as decentralized currencies have not been "authorized or adopted by a domestic or foreign government as a part of its currency." A person or entity engaged in the transmission of decentralized currencies, as they currently exist, would not be required to obtain a TOMA license. However, should transmission of decentralized digital currencies involve "money" in a transaction, that transaction may be considered money transmission depending on how the transaction is organized. Any person or entity engaging in a transaction involving both

decentralized digital currencies and “money” should request a determination from the Department on whether or not such activity will require a TOMA license.

Regulatory Treatment of Digital Currencies:

In order to provide further guidance and clarity around how digital currencies are currently regulated, listed below are some examples of common types of digital currency transactions. Please note this is a non-exhaustive list.

Activities Generally Qualifying as Money Transmission

- Exchange involving both digital currency and sovereign currency through a third party exchanger is generally considered to be money transmission. For example, some digital currency exchange sites facilitate exchanges by acting as an escrow-like intermediary. In a typical transaction, the buyer of digital currency sends “money” to the exchanger who holds the funds until it determines that the terms of the sale have been satisfied before transmitting the funds to the seller. Irrespective of its handling of the digital currency, the exchanger conducts money transmission by receiving the buyer's “money” in exchange for a promise to make it available to the seller.
- Exchange of digital currency for sovereign currency through an automated machine is generally considered to be money transmission. For example, several companies have begun selling automated machines commonly called “Bitcoin ATMs” that facilitate contemporaneous exchanges of digital currency for sovereign currency. Most such machines currently available, when operating in their default mode act as an intermediary between a buyer and seller, typically connecting through one of the established exchange sites. When a customer buys or sells bitcoins through a machine configured this way, the operator of the machine receives the buyer's money in exchange for the “business or receiving money for transmission or transmitting money.”

Some digital currency ATMs, however, can be configured to conduct transactions only between the customer and the machine's operator, with no third parties involved. If the machine never involves a third party, and only facilitates a sale or purchase of digital currency by the machine's operator directly with the customer, there is no money transmission because at no time is money received in exchange for the “business or receiving money for transmission or transmitting money.”

Activities Not Qualifying as Money Transmission

- Exchange of digital currency for money directly between two parties does not qualify as money transmission. This is essentially a sale of goods between two parties. The seller gives units of digital currency to the buyer, who pays the seller directly with “money.” The seller does not receive “money” with the intent to transmit it to another entity or “engage in the

business of exchanging, for compensation, money of the United States Government or a foreign government to or from money of another government.”

- Transfer of digital currency by itself is not transmitting money. Because digital currency is not “money”, the receipt of it with the intent to transmit it to another entity is not “transmitting money.” This includes intermediaries who receive digital currency for transfer to a third party, and entities who, akin to depositories (commonly referred to as wallets), hold digital currency on behalf of customers.
- Exchange of one digital currency for another digital currency is not money transmission. Regardless of how many parties are involved, there is no receipt of “money” and therefore “transmitting money” does not occur.
- A merchant who accepts digital currency as payment for goods or services or an individual who pays for goods or services with digital currency are commonly referred to as “users” of digital currency. Regardless of how many parties are involved, no “money” is involved at any point in this transaction, so “transmitting money” does not occur.
- “Miners” or those who receive digital currency as payment for verifying transactions, typically by contributing software, connectivity, or computing power to process transactions. Although “miners” receive payment of digital currency for completing its work, “money” is not involved in the payment of this work, so “transmitting money” does not occur.
- Multi-signature software allows users to distribute authority over his or her digital currency among multiple different actors. This software requires multiple actors to authorize a digital currency transaction before the transaction can be consummated. Specifically, a multi-signature provider holds one of two or more private keys needed to authorize transactions. Regardless of how many parties are involved, no “money” is involved at any point in this transaction, so “transmitting money” does not occur.
- Blockchain 2.0 technologies refer to the use of a digital currency’s decentralized or distributed ledger system for non-monetary purposes such as verifying ownership or authenticity in a digital capacity. This technology includes software innovations such as colored coins (i.e. coins that are marked specifically to represent a non-monetary asset), smart contracts (i.e. agreements implemented on a distributed ledger), and smart property (i.e. property that is titled using a decentralized distributed ledger). These uses for non-monetary purposes may use digital currency as a medium of exchange, but do not involve the exchange or transmission of “money” or the sale or issuance of a “payment instrument” and as a result “transmitting money” does not occur.

Licensing Considerations

- A digital currency business that conducts money transmission, as outlined above, must comply with all applicable licensing, reporting, net worth and other relevant requirements of the Transmitters of Money Act 205 ILCS 657/1 *et seq.*
- Any entity engaged in money transmission must comply with the permissible investment requirements as defined in 205 ILCS 657/50. No virtual currency has been approved by the Director as a permissible investment under this section. However, pursuant to 205 ILCS 657/50(b) at any time, the Director may approve or limit the extent to which other products may be considered a permissible investment.