



Bitcoin Beach

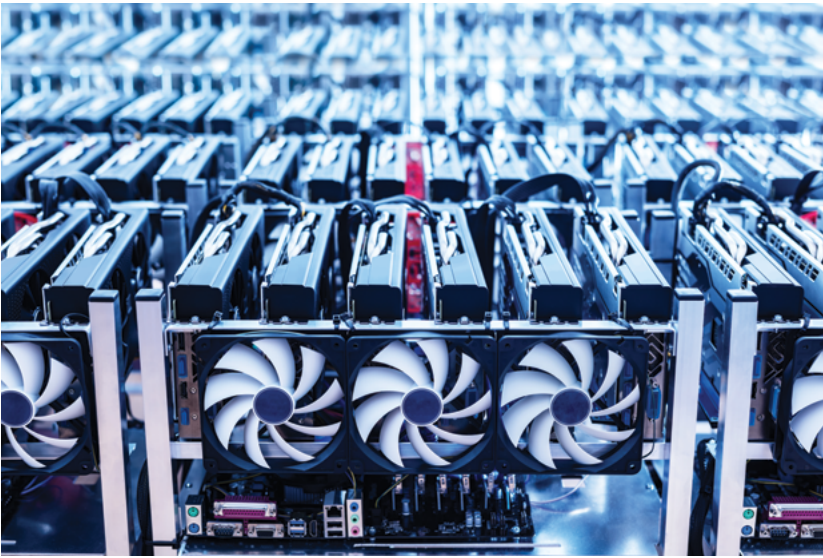
Reforms to Attract Cryptocurrency Innovation and Investment in the Sunshine State

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Introduction

Florida can and should become a leader in the advancement of cryptocurrency. In one short decade, Bitcoin (the most widely known cryptocurrency) has grown from a little-known computer science project of dedicated hobbyists to a professionalized financial industry boasting a currency market capitalization of well over \$100 billion.

This value is well-earned: by overcoming two long-standing barriers in computer science that had prevented distributed data verification—called the double-spending problem¹ (which prevented digital scarcity) and Byzantine general's problem² (which prevented distributed consensus)—Bitcoin generated a true paradigm shift by allowing direct peer-to-peer payments online for the first time. In other words, this technology has offered an alter-



native to many traditional financial institutions operated by central trusted third parties.³

For these reasons, many regulations that were drafted to constrain or oversee centralized financial institutions fit awkwardly if applied to cryptocurrency firms (and even private individuals) that operate in a partially- or fully-decentralized manner. Legislators hoping to encourage innovation and investment in Florida therefore have ample “low-hanging fruit” to harvest by reviewing and rationalizing our regulations to more appropriately take account of these technological advances.

Florida is in an especially fortuitous position to be a leader in cryptocurrency policy. The Sunshine State boasts a large, highly-skilled, and creative labor force; as the state looks to diversify our economy away from hospitality and agriculture, technology is a promising candidate. Our welcoming tax and regulatory systems are attractive to businesses who may be considering relocating from the more hostile environments of other large states. We are also home to Miami, the unofficial capital of the Latin world. Cryptocurrency is especially important to this population as a potential vehicle for remittances or savings in countries with poor monetary management.⁴ And our world class beaches and natural beauty are unparalleled, further enticing potential investment.

This paper will briefly explain what cryptocurrency is and how it works before examining the current state of applicable Florida regulations and law. We will examine how these rules impact cryptocurrency businesses and how they compare to those in two other states: Wyoming and New York. We will conclude with some prac-

tical and concrete steps that legislators can take now to position Florida as a leader in cryptocurrency policy and industry, as well as future areas of analysis needed to continue along this path.

A Bit About Bitcoin

Bitcoin is a private (non-state) digital peer-to-peer currency that was created by a pseudonymous programmer named Satoshi Nakamoto in 2009.⁵ It was the first “cryptocurrency,” and many others have been developed in this model with different features. The key commonality is that transactions are managed and verified by a distributed network of computers rather than a central entity like a bank or payment processor or credit card company. Many cryptocurrencies limit the total number of coins that can be mined in its code; Bitcoin, for instance, has a currency limit of 21 million.

Interested readers can find several in-depth explanations on how the network works.⁶ Nevertheless, legislators do not need a degree in computer science to understand cryptocurrency basics and how they relate to state law.

Traditional centralized financial institutions both hold customer funds and actively move money when a customer makes a transaction. This means the institution must secure detailed records about each customer’s identity, accounts, and transaction history as well as the ability to move funds on a customer’s behalf—all of which would be disastrous in the hands of hackers or criminals.

Cryptocurrency requires no such centralized management. Cryptocurrency users may hold complete control of their accounts and money at all times. To make a transaction, they simply sign their private key (which serves like a password) to broadcast the change to the network. The network then blindly moves the money to the broadcasted recipient without needing direct control of any account or specific knowledge about any party. Computers that run the network, called “miners” or “nodes,” may receive newly minted coins as an incentive to contribute their processing power to the network.⁷ At no point does any central third party have access to or control of the money.⁸

Traditional centralized financial institutions keep track of all transactions using internal records. These are necessarily secret, and may be a vector for fraud, which motivates many existing financial regulations.

With cryptocurrency, all base layer transactions (meaning transactions that take place on the block-

chain)⁹ are fully public for all time and immutable, meaning that a criminal cannot retroactively cover their tracks. The public ledger of all cryptocurrency transactions is known as the blockchain.

What are the benefits?

Bitcoin's impressive market capitalization is well-earned.¹⁰ By eliminating the need for a trusted third party to make transactions, cryptocurrency makes many arrangements possible for the first time.

Financial autonomy. First, it affords individuals complete control over their finances.¹¹ They do not need to trust that a bank or payment processor will correctly manage their money or personal data. Given the rise of problems like hacks on financial institutions,¹² this is an attractive option for technologically-savvy cryptocurrency users.

In many ways, cryptocurrency is an inevitable product of the internet age. An instructive comparison can be made with digital communications. In the past, people who wished to broadcast a message would be limited to third-party managed platforms such as radio, television, and publishers. If that message was deemed unimportant or threatening to powerful groups, these third parties might decline to publish it. The internet afforded a more peer-to-peer option. Anyone can start their own blog and shout their thoughts to the world without permission. The end result was more liberty, especially for those who may be unpopular among powerful groups.

For the first time, Bitcoin allowed this same dynamic with online money. People who use cryptocurrency don't need to worry that their transactions will be denied because of a mistake or, in the extreme case, persecution. This is a particularly important use case for Florida, which has welcomed considerable numbers of victims of political oppression to our shores, many of whom still have loved ones in dire political climates.

Bitcoin and cryptocurrencies are also useful as private monies. Legacy financial institutions view Bitcoin as a promising asset class in its own right.¹³ Because the total number of bitcoins is finite, it functions in a similar manner to gold. Unlike gold, bitcoins do not need to be lugged around and physically secured by people holding guns. Cryptocurrencies are trivially easy to transfer, unlike bulky hard metals. As long as you can keep your private key a secret, your bitcoins will be safe.

Savings and remittances. More relevant to the state of Florida, cryptocurrency affords our many immigrant

communities with a reliable and secure means to send money to relatives living in unstable or poverty-stricken countries.¹⁴ While governments may put pressure on traditional financial institutions to block transfers to or from certain countries, bitcoin transfers are next to impossible to prevent.

For example, the government of Venezuela has imposed strict capital controls on its citizens, who are forced to suffer through their government's monetary and fiscal mismanagement.¹⁵ This makes it harder for Venezuelan Americans to help their families.

Bitcoin and cryptocurrency provide a desperately needed alternative to provide aid through remittances and savings that cannot be blocked or confiscated by any party. It is not surprising that Latin Americans living in unstable societies have been particularly enthusiastic Bitcoin users.¹⁶ This also partially explains why Miami has attracted so much cryptocurrency activity.¹⁷

Next-generation data validation. Finally, Bitcoin and cryptocurrency are promising stand-alone technologies. Blockchains allow distributed computers (numerous computers located all over the world) to agree on data without relying on a trusted third party for validation. To date, those "data" have represented money, but it is possible that such data could represent other things, like predictions or property. Blockchains can therefore be used to operate futures markets, track ownership, or even allow automatically-enforced contracts, called "smart contracts."¹⁸ To realize the full benefits of next-generation applications like these, we must ensure that regulations intended to promote certain ends don't end up accidentally quashing these novel and quite beneficial uses.

What are the risks?

Lawmakers reasonably wonder what some of the downsides of cryptocurrency may be. Fortunately, the most serious concerns about cryptocurrency, namely that it is an especially attractive vehicle for crime or money-laundering, have proven to be largely unwarranted.

Still, there are legitimate issues regarding user security about which public organizations would do well to educate consumers. Furthermore, where cryptocurrency businesses essentially function as a cryptocurrency-denominated custodian or transmitter, appropriate oversight will be needed. In other words, businesses should not be unaccountable simply because they happen to involve cryptocurrency. As we will see, scam-

mers have taken advantage of legal ambiguities to bilk millions from unsuspecting victims by pretending to be a distributed cryptocurrency. Oversight and education can help to limit these risks.

Money-laundering and crime. Because cryptocurrency allows direct payments, lawmakers initially worried that this technology would facilitate money laundering and crime. This is because anti-money laundering/know your customer (AML/KYC) regulations had traditionally relied on third parties reporting transactions to the authorities.

It is true that crime has been committed using Bitcoin, just as it has been committed using the U.S. dollar, the first choice of international crime. However, using cryptocurrency is perhaps one of the worst ways to commit a crime. This is because the blockchain record of all transactions is public, immutable, and accessible for all time.

In other words, law enforcement has a friend in the blockchain because it can provide useful evidence without requiring the collaboration or honesty of a third party. In fact, many cryptocurrency firms specialize in blockchain analysis precisely to assist law enforcement in forensic tracing. Such evidence has been used many times in successful prosecutions.

Federal regulations, particularly those outlined by the Financial Crimes Enforcement Network (FinCEN) of the U.S. Treasury Department, recognize the distinction between a private individual or non-custodial business that interacts with cryptocurrency and those cryptocurrency businesses who operate like traditional money transmitters and banks, freeing the first group from the regulations on the second.¹⁹ Florida should follow the federal lead.

Personal security. A more pressing problem stems from personal security and consumer protection.²⁰ One reason people like trusted third parties for financial interactions is that they provide a degree of insurance against fraud and mistakes. If someone steals your credit card, your company may reverse the fraudulent charges, for instance.

With direct cryptocurrency payments, there is no such potential for a chargeback if a person sends money to the wrong address. Furthermore, if a hacker gets hold of someone's private key, they can drain all the money in an account without the potential for a forced on-chain reversal.

For many cryptocurrency users, the benefits of financial autonomy outweigh the security risks, so they are comfortable with this arrangement. Yet it does require a level of technical proficiency.

New cryptocurrency users are often unaware of these security risks. The state of Florida has taken positive steps to educate the public of such risks.²¹ Focusing on educating the public about personal security risks and best practices is a laudable goal for Florida regulators, in addition to providing the appropriate oversight for true third-party cryptocurrency money transmitters and financial institutions.

Scams and fraud. Scams involving fake cryptocurrency and illegal security products are another challenge in this space. During the so-called “initial coin offering” or ICO boom of 2017, where purportedly blockchain-based products advertised IPO-like investment vehicles to unsuspecting novices, many people lost significant amounts of money on what were eventually revealed to be scams.

For instance, the much-hyped “OneCoin” project styled itself as a revolutionary cryptocurrency that would yield great returns to investors. In reality, it was a pyramid scheme, and the technology behind it did not exist at all.

Unsuspecting victims lost thousands of dollars in the scheme, including many Floridians.²²

Such “cryptocurrency-in-name-only” scams clearly violate federal and state securities laws and should be prosecuted accordingly when found. But there is a role for state regulators to educate the public so they can identify and avoid these scams before becoming victims. Florida Chief Financial Officer Jimmy Patronis took proactive steps to promote consumer protection and education in designating a “cryptocurrency czar” to lead such efforts at the height of the mania in 2018.²³ The state should build on such efforts to help Floridians better understand the red flags to identify and avoid.

Rationalizing our rules

Although cryptocurrency can serve as a money and payment network, it works very differently than traditional monies and payment networks because a central third party is not necessary to make it work. This creates regulatory friction, since many existing rules that govern money and payment networks are premised on the assumption that a central third party can access and

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control money on their customers' behalf.

Florida has a great opportunity to review its regulatory code and legal interpretations to identify and remove these frictions. A successful exercise will bring state policy in line with federal standards and ensure that private individuals and businesses that are not acting as custodial banks or money transmitters are not treated as such by law while retaining the consumer protections and oversight for those entities that are acting as custodial intermediaries.

As we will see, the current state of Florida law technically prohibits individuals from selling cryptocurrency without first obtaining a costly and time-consuming money transmission license. These regulations were not intended to prevent individuals from engaging in direct commerce. Furthermore, businesses that deal in cryptocurrency on a non-custodial bases are also treated as money transmitters by law even though they are not in fact money transmitters. Legislators should review these laws to consider changes that would be more appropriate for the cryptocurrency space.

The State of State Cryptocurrency Regulations

Unlike states such as Wyoming and New York, Florida has yet to reform its regulations given advances in cryptocurrency. The biggest source of regulatory friction now concerns how the interpreted legal definition of “money” interacts with currency money transmission regulations.²⁴

Money transmission regulations are primarily aimed at consumer protection. A “money transmitter” is generally defined as a third party entrusted to hold and send funds on a customer's behalf (i.e. a traditional bank). In this arrangement, there is an obvious potential for fraud or mismanagement. An especially unscrupulous money transmitter could simply abscond with the funds. A negligent one could succumb to hacks or scams.

States have therefore developed bodies of money transmission regulations to prevent such carelessness by custodial transmitters. Money transmission regulations generally require a money transmitter to pay fees and apply for and maintain a state license. Oversight boards may require periodic reports or audits as well.

Many money transmission regulation regimes are problematic enough as currently constituted.²⁵ Where the costs of applying for a license or complying with the rules are sufficiently high, money transmission reg-

ulations can serve as a barrier to entry, which limits competition and therefore the number of options for consumers.

Worse yet, money transmission companies currently must expend resources on remaining compliant with the regulations of each state, regardless of the overlap in rules. States may have reciprocity arrangements, whereby companies that satisfy the requirements of one state may legally operate in another. Florida has no such reciprocity arrangement, which means that it is that much more expensive for companies to set up operations within our borders. Large companies may be able to shoulder these costs, but smaller upstarts, who may bring promising innovations, almost certainly cannot.

Florida cannot unilaterally change our state patchwork of money transmission regulations. However, it can ensure that our regulations make sense and allow for consumers to be served by ample competition. One good place to start is to review how money transmission regulations affect innovative cryptocurrency applications.



Florida money transmission rules

Florida's money transmission regulations can be found in Chapter 560 of Title 33 of the 2011 Florida Statute and are administered by the Office of Financial Regulation of the Florida Financial Services Commission.

Companies with a net worth of at least \$100,000 (plus an extra \$10,000 for each additional branch up to \$2,000,000) must pay a one-time \$375 application fee (plus additional charges of \$38 for each branch and au-



thorized vendor up to \$20,000) and an annual \$750 fee after obtaining a license (plus additional charges of \$38 for each branch and authorized vendor up to \$20,000 biennially). A licensed company must also obtain a surety bond of a minimum of \$50,000 and maximum of \$2,000,000 (dependent on transmission volume) as insurance. As mentioned, Florida does not have reciprocity agreements with other states. Licensees must maintain documentation and periodic reports to submit for review to ensure compliance with the license rules.

Compared to other states, Florida's money transmission rules are not especially onerous. The application and annual fees are on the low end of average, for instance. Still, the state's lack of reciprocity arrangements likely creates unnecessary costs with no change in regulatory outcomes.

The challenge for cryptocurrency firms comes from Florida's inappropriate application of money transmission regulations upon non-custodial cryptocurrency firms. As currently interpreted, even private individuals may have to register as money transmitters in order to legally make a transaction.

Money transmission regulations and cryptocurrency firms

In the absence of a legislative update to money transmission laws²⁶ that explicitly takes cryptocurrency

into account, Florida's current regime has been instead fleshed out by administrative bodies and the courts.

Initially, court decisions and administrative guidance seemed to be converging on a standard in line with federal FinCEN guidelines. For example, a 2016 circuit court decision in *State of Florida vs. Espinoza* ruled that the defendant was not guilty of money laundering or operating an unlicensed money transmission business because Bitcoin is not money, partially because the Bitcoin was not widely accepted when the events occurred in 2014, and partially because Bitcoin is not merely money, but is also a decentralized system.

While it is admirable that the judge showed an early, if incomplete, understanding of cryptocurrency's distributed properties, this decision relied in part on Bitcoin's relative disuse as money. Now that cryptocurrency is widely accepted across the world, this legal argument no longer holds weight. Legislative changes later cemented these interpretive problems: In response to the early *Espinoza* decision, Florida amended the Florida Money Laundering Act to include "virtual currency" as a type of "monetary instrument," which is defined as "a medium of exchange in electronic or digital format that is not a coin or currency of the United States or any other country."²⁷ While this change would indeed penalize true acts of money laundering undertaken with virtual currency, it did not address the specific subject of money transmission regulations.

In a November 2018 declaratory statement on a cryp-

to cryptocurrency business's application to operate in the state of Florida, the Office of Financial Regulation ruled that the firm would have to obtain and maintain a license because it offered custodial services to customers.²⁸ The fact that the business may happen to be in custody of cryptocurrency was immaterial to the decision. In other words, an individual or business offering non-custodial services would not be compelled to obtain a license simply because cryptocurrency was involved.

This decision cohered with FinCEN's most recent guidance on money transmission rules.²⁹ The guidance clearly exempts those who are engaged in non-custodial cryptocurrency uses from money transmission rules. Specifically, if an entity is an "exchanger," or "a person engaged as a business in the exchange of virtual currency for real currency, funds, or other virtual currency" then they will need to register and comply with federal anti-money laundering rules. If, on the other hand, an entity is a "user," or "a person that obtains virtual currency to purchase goods or services" on that person's own behalf, that entity will be exempt from the law. FinCEN further clarified that only persons who have "independent control" over other persons' virtual currency are, in fact, money transmitters subject to federal AML/KYC law. Persons who are, for example, merely developing bitcoin software, or who are mining or relaying transaction messages on the peer-to-peer bitcoin network, have no independent control over the currency of others and they are therefore exempt.

A "user" is someone who engages with cryptocurrency on a non-custodial basis; he is handling his own funds rather than someone else's, and therefore has no reason to be subject to regulations intended to promote consumer protection by custodial firms. A software developer, miner, or transaction relayer is someone who is also non-custodial; she is engaging with the protocol and computer network that supports a cryptocurrency but has no ability to redirect, steal, or otherwise control the units of cryptocurrency sent over that network. That person too, therefore, has no reason to be subject to regulations focused on custodial risks.

Unfortunately, legal vagueness involving how the state of Florida's definition of money affects money transmission norms later resulted in the unfortunate but predictable appellate court decision on the *Espino-*

za case in 2019.³⁰ The court rejected the lower court's ruling that cryptocurrency was not money and therefore not subject to money transmission regulations because there are clearly people who are willing to accept cryptocurrency in exchange for goods and services.

But the appellate court ignored the lower court's understanding of the distributed nature of cryptocurrency as well as the 2018 guidance from the Office of Financial Regulation, arguing that a plain reading of the statute indicated that no third-party custody function was necessary for money transmission rules to apply on the state level.

As legal commentators have pointed out,³¹ this decision effectively made it illegal for even private individuals to sell cryptocurrency for any reason within the state of Florida without a license. One analysis in the *National Law Review* concluded that, "In Florida,

therefore, firms seeking to buy, sell, or otherwise integrate digital assets into their business model may face uncertainties about whether a money transmission license is required."³² Adding more complications, the *Espinoza* case appears inconsistent with the Office of Financial Regulation's declaratory statement, and the office has yet to reconcile the two interpretations.³³

So far, no individual has been prosecuted on that basis, but it is a real threat to cryptocurrency users and businesses and an unnecessary ambi-

guity in state law.

As we have seen, FinCEN guidance clearly and wisely distinguishes between custodial and non-custodial cryptocurrency functions, exempting the latter from money transmission regulations. However, the *Espinoza* decision highlights an unnecessary snag in Florida law which could easily be remedied by legislation. Specifically, the state could clearly separate custodial from non-custodial uses of cryptocurrency and exempt the latter from money transmission regulations.

Not only is this application of money transmission regulations clearly burdensome on private individuals and non-custodial businesses who wish to operate in the state of Florida, it is not in keeping with the spirit of the money transmission rules or the generally analogous federal standards for registration with FinCEN.

Private individuals should not be burdened with consumer protection laws as there is no consumer to protect. Nor should businesses that do not hold funds

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on customers' behalf be subject to these rules since there is no way for those firms to lose customer funds and, therefore, there is no consumer protection interest at stake.

Recent legislative efforts

The original lower court Espinoza decision wisely indicated that the current ambiguity in how Florida money transmission regulations affect cryptocurrency activities necessitated "legislative action geared towards a much-needed update to the particular language within this statute." That call is even more prescient today, with our schizophrenic legal environment where the courts and relevant administrative agency have put forth two contradictory interpretations.

Although Florida has yet to legislatively clarify the specific language surrounding money transmission, it has taken several promising steps.

First, Florida created a new Blockchain Task Force in 2019 to specifically study cryptocurrency technology and its benefits for Florida. While it was not given a specific mandate to study money transmission rules, its charge to "make recommendations to the Governor and the Legislature that will promote innovation and economic growth by reducing barriers to and expediting the expansion of the state's blockchain industry" may result in helpful deregulatory efforts.³⁴

Next, the House Bill 1391 proposal to create a regulatory sandbox for financial technology, or "fintech," firms is another promising step.³⁵ A regulatory sandbox affords a relatively deregulated space for small and innovative firms to experiment under the watch of regulators without the typical costs of established regulations. Regulatory sandboxes generally set some threshold in terms of size or revenue at which point sandbox firms "graduate" into the traditional regulatory environment. The idea is that by loosening state reins on small innovators, they can have the breathing room to grow and better serve customers.

Florida's proposed fintech sandbox explicitly identifies money transmitters for participation in this deregulated but monitored environment. It specifies that innovative companies with certain limited numbers of customers may apply for extendable waivers from the Office of Financial Regulation for a "sandbox period" initially no longer than 24 months, which exempts that firm from state money transmission rules.³⁶ The applications must explain how current regulations prevent them from offering an innovative financial product

before describing the business plan, personnel, and potential risks to consumers. Sandbox participants must submit to reporting and consumer information requirements and are limited to serve set levels of customers as determined by the Office.

The proposed sandbox is a positive step towards allowing more innovation. But while this measure would afford a bit more breathing room for actual money transmitters, the vagaries in state law surrounding money transmission would still impact non-money transmitters who wish to use cryptocurrency in innovative ways. As written, for instance, a business who merely wishes to accept cryptocurrency in exchange for goods and services might neglect to adopt such innovative practices for fear of running afoul of state law. Legislators should build on the positive momentum generated by the fintech sandbox to consider broader reforms to state money transmission laws that will free even more innovators within our state.

A Promising Template: the Uniform Law Commission's "Uniform Regulation of Virtual Currency Business Act"

As mentioned, legislators could look to FinCEN guidance on money transmission which exempts non-custodial applications as a model. The Florida legislature also has a handy template in the form of the Uniform Law Commission's (ULC) model state legislation called the Regulation of Virtual Currency Businesses Act (RVCBA).³⁷ Since 1892, the ULC has drafted "non-partisan, well-conceived, and well-drafted legislation that brings clarity and stability to critical areas of state statutory law."³⁸ Florida has enacted several ULC model and uniform acts into law.³⁹

The RVCBA also contains a fintech sandbox similar to the one passed in the 2020 legislative session. But the act goes further by clarifying the legal definitions of concepts in money transmission laws that have led to confusion in court and administrative interpretation.

Specifically, the RVCBA outlines three major use cases for cryptocurrency businesses that would trigger money transmission licensing requirements. If a business is engaged in the:

- (1) "exchange" virtual currency, which means to "assume control of virtual currency from or on be-

half of a resident, at least momentarily, to sell, trade or convert: (a) virtual currency for legal tender, bank credit, or for one or more forms of virtual currency; or (b) legal tender or bank credit for one or more forms of virtual currency”;

(2) “store” virtual currency, which means to “maintain control of virtual currency on behalf of a resident by a person other than the resident”: or

(3) “transfer” virtual currency, which means to “assume control of virtual currency from or on behalf of a resident and to (a) credit the virtual currency to the account of another person; (b) move the virtual currency from one account of a resident to another account of the same resident; or (c) relinquish control of the virtual currency to another person”

that business would be subject to normal money transmission regulations, except for those that engage in small enough volumes to be protected by the fintech sandbox.

Notice that in each scenario, custodial control of the funds is explicitly specified, where control is defined as “power to execute unilaterally or prevent indefinitely a virtual-currency transaction.” This is an appropriate designation as it applies regulations intended to oversee custodial third parties to those entities while sparing non-custodial parties from inappropriate and innovation-killing requirements.

The act also specifically exempts entities using cryptocurrency for personal use from the burden of money transmission regulations, which is currently an area of legal uncertainty in Florida. Under the RVCBA, a person “using virtual currency, including creating, investing, buying or selling, or obtaining virtual currency as payment for the purchase or sale of goods or services, solely: (a) on its own behalf; (b) for personal, family, or household purpose; or (c) for academic purposes” is exempt. “Person” is defined to include both natural persons as well as businesses.

The net effect of the RVCBA is to clarify that cryptocurrency businesses that act as money transmitters, i.e. have custody of consumer funds, will indeed be regulated as such. Specifically, third-party wallet providers and custodial exchanges, which respectively act as depository and exchange institutions, would be subject to state regulations, provided they are not small enough to be part of the less regulated fintech sandbox. The RVCBA also clearly exempts entities such as

private individuals and households, network operators and maintainers, software developers, next-generation cryptocurrency applications,⁴⁰ and cryptocurrency-accepting businesses from money transmission regulations.

Cryptocurrency advocates have praised the RVCBA as a strong and pro-innovation state model law which can “save innocent innovators from unwarranted persecution, promote innovation by exempting non-custodial actors who should never be regulated, and help consumers of custodial services with common sense protections.”⁴¹ To become a leader in the cryptocurrency space, Florida should strongly consider these policies.



A Tale of Two States: Wyoming and New York as Case Studies

A great strength of the U.S. system of federalism is that it affords states the freedom to experiment and learn from the examples of others. In the case of cryptocurrency policy, Florida has two case studies on each pole of the spectrum to examine: those of Wyoming and New York.

As we will see, policies that clearly and accurately define cryptocurrency in law and place the appropriate rules on distinct applications yield regulatory clarity and therefore space for innovation and growth. At the other extreme, policies that poorly define technologies and applications while placing onerous restrictions on broad classes of activities will stifle growth and innovation.



Wyoming: Open for “bitness”

Wyoming may be the least populous state in the Union, but it may be home to the greatest number of cryptocurrency businesses. This is because the state has enacted the world’s most ambitious and comprehensive pro-innovation cryptocurrency regulatory reforms with the express purpose of attracting investment and entrepreneurs.⁴² The result: a state that was once associated with wide open plains and cowboys has now attracted dozens of tech startups in just a few years.

Wyoming was not always crypto-friendly. Five years ago, Wyomingites could not legally open an account on Coinbase, the largest cryptocurrency exchange. Today, Wyoming is home to the world’s first Bitcoin native bank.⁴³

Wyoming’s success in cryptocurrency reform comes in large part thanks to the Wyoming Blockchain Coalition, a lobbying group that helped to shape and promote the state’s new regulatory system.⁴⁴ The result is 13 separate laws that “recognize the direct property rights for individual owners of digital assets,” “create a fintech sandbox,” “authorize a new type of state-chartered depository institution to provide basic banking services” to businesses, and “authorize the first true ‘qualified custodian’ for digital assets which is a bank.”⁴⁵

Wyoming’s unofficial nickname as the “Delaware of cryptocurrency businesses” is apt. Both brand new startups and billion-dollar crypto projects have relocated to Wyoming in response to the state’s innovation-friendly reforms.

While every single reform that Wyoming made may not necessarily prove appropriate for Florida, the Cowboy State’s deregulatory posture provides a strong case

study in how smart reforms can attract growth and innovators. At the very least, Florida should clarify basic rules such as money transmission regulations to put the state in a better position to one day pursue more complex reforms such as changes to banking charter rules to attract cryptocurrency banking.

New York: Innovation not welcome here

If Wyoming is an example of excellence, New York’s approach to cryptocurrency is a case study in what *not* to do. Rather than reforming laws to welcome the growth of a promising new industry, the New York State Department of Financial Services (NYDFS) created an onerous licensing scheme specifically for cryptocurrency firms with which few businesses could ever hope to comply. The result has been a mass exodus of cryptocurrency firms from the state of New York, which robs denizens of a whole class of promising technologies.

Crypto-watchers were cautiously optimistic when the state announced its intentions to update money transmission regulations given advances in cryptocurrency. Although there is always a threat that new regulations will be poorly-considered, the previous regulatory environment where there was no certainty at all around how the state would consider cryptocurrency stifled growth in its own way.

The results were disappointing. After months of consultations with technologists and entrepreneurs within the cryptocurrency community, the final regulations put forward by NYDFS, called the “BitLicense,” were vague, onerous, and expensive.⁴⁶

Cryptocurrency businesses were and still are unclear

as to exactly when their activities trigger licensing requirements. Unlike the clear definitions of covered activities found in the ULC's RVCBA discussed earlier, the BitLicense's definition of Virtual Currency Business Activity can be interpreted to include individual users as well as several other non-custodial entities within the licensing requirement.⁴⁷ Worse yet, cryptocurrency-focused money transmitters are treated even harsher than their traditional currency equivalents: for example, if a cryptocurrency money transmitter wants to offer a new kind of product, it first has to be approved by the NYDFS. Finally, the law lacks a fintech sandbox that can encourage new upstarts to innovate without regulatory barriers. This effectively killed new upstarts in New York, as one executive estimated that the total cost of compliance with the BitLicense exceeded \$100,000.⁴⁸

It is not surprising that New York has only awarded 25 BitLicenses since the process was first formalized in 2015.⁴⁹ Nor is it surprising that the advent of the NY BitLicense heralded a flood of cryptocurrency firms fleeing the state's harsh regulations.

Not only has the BitLicense been an innovation-killer, it has generated concerns about regulatory capture. Economists use this term to refer to situations where a regulatory body or process is "captured" by some private interests to serve those ends rather than consumer welfare.⁵⁰

In the case of the BitLicense, the harsh regulations may function as a means to keep out competition and consolidate the market positions of the lucky few that have obtained BitLicenses or those in traditional money transmission services that do not need one. That the former financial regulator who created the BitLicense later founded a consulting group that charges heavy fees to help well-funded entities navigate the complex BitLicense process does not help the perception that New York's cryptocurrency regulations serve private interests more than consumers.⁵¹

New York's experience with the BitLicense has been so bad that NYDFS recently announced broad reforms to their cryptocurrency money licensing policies.⁵² One positive change is that NYDFS is partnering with the State University of New York (SUNY) to operate a "conditional license" program for startups that will

have stripped-down costs and requirements, similar to a fintech sandbox.⁵³ The new rules would also explicitly exclude some non-custodial actors like miners and software developers.

However, the BitLicense could still apply to other non-custodial actions such as a special kind of transaction called a multi-signature transaction.⁵⁴ It also maintains high fees and limitations on businesses that have obtained a BitLicense.⁵⁵ While it is admirable that New York has improved the BitLicense process, it lost a half a decade of possible innovation in the meantime, and the money transmission rules still need a lot of work to be truly innovation-friendly.

In reviewing how to best update money transmission regulations to consider cryptocurrency activity, Florida should reject any proposals, like the BitLicense, that make it harder or more expensive for a business

to operate just because it happens to involve cryptocurrency. Custodial money transmitters should be treated the same in law whether the money they manage is cryptocurrency or traditional currency. Businesses and individuals who are not engaged in any custodial functions, whether with cryptocurrency or traditional currency, are not acting as money transmitters and should not be treated as such by law.

New York's onerous and vague regulations have killed cryptocurrency innovation in that state with no meaningful benefits for consumer protection. Florida should reject New York's BitLicense approach.

► *Updating money transmission regulations is a cheap and easy way to attract cutting-edge cryptocurrency businesses to our borders.*

Recommendations for the Road Ahead

Florida has a great opportunity to reform its money transmission regulations and position the Sunshine State as a leader in the world of cryptocurrency. As we have seen, by applying the same standard to cryptocurrency firms and individuals that we do to traditional currency analogs—that is, triggering money transmission licensing and oversight requirements when an entity serves as a third-party custodian—Florida can bring rationality and fairness to its policies.

This easy change will not only better serve and protect customers in our state, it will prove attractive to cryptocurrency entrepreneurs and businesses seeking

a hospitable environment for innovation. Florida has sought to expand the technology presence in our state through efforts such as Enterprise Florida and investments in the Florida Polytechnic University. Updating money transmission regulations is a practical and efficient way to attract cutting-edge businesses to our borders.

But there is an even more important reason to reform our policies. Because Florida is already home to large immigrant populations that send remittances back home, these changes will provide more options for families weathering difficult situations in unstable countries. This is not only a matter of economic growth but, to some of our residents' loved ones, it is a matter of economic survival.⁵⁶

With that in mind, here are a few general policy recommendations and future avenues of research for the road ahead:

1. **Review and reform money transmission laws to exempt non-custodial services and applications:** To resolve inconsistencies and burdens within Florida's current interpretations of how money transmission rules apply to cryptocurrency activities, the legislature should consider the ULC's RVCBA. Clearly distinguishing between custodial and non-custodial applications of cryptocurrency and exempting the latter not only would be consistent with analog institutions, it would better serve Florida residents and position our state as a hub of cryptocurrency activity.
2. **Avoid new restrictions on innovative technologies and applications:** In general, Florida should embrace a posture of "permissionless innovation" when it comes to emerging technologies.⁵⁷ Requiring entrepreneurs to apply for and maintain expensive licenses for infant technologies imposes a real impediment to change and growth. Rather than inadvertently stifling new industries with precautionary regulations, the state should instead allow space for tinkerers to experiment under the watch of the relevant agency, just as the House has recommended with its proposed fintech sandbox. Innovation is hard to create but trivially easy to kill. Our laws should not be the reason that a new technology fails to take flight.

3. **Avoid government investment or endorsement of any particular technology or application:** Just as governments should not target specific technologies or applications negatively, neither should they do the reverse. Subsidizing or propping up preferred use cases distorts market signals. Technologies that appear promising today may not end up being the market winner. If the state were to privilege what would otherwise be a technological loser, we would risk getting stuck in an inferior standard.

Furthermore, the state should approach government adoption of blockchain technologies very cautiously. While it is admirable that legislation proposed so far showed interest in how the state of Florida can adopt blockchain technology for things like property registration, legislators should keep in mind that these are new and still developing technologies. Private businesses can experiment in ways that state governments cannot, for both constitutional reasons and to protect the public interest. The legislature should first focus on reforms that will unlock cryptocurrency's full potential within the state. Once these technologies are more tested and vetted, the state will have a better idea of which are safe enough for government use.

4. **Consider updating state banking regulations in light of advances in cryptocurrency:** Florida should first look to reform its money transmission laws as it is the simplest policy change with a great payoff in improvements to our regulatory environment. But there is much more that can be done. Legislators could consider studying Wyoming's experience in reforming state banking charter rules as a path for Florida to follow; perhaps the state's Blockchain Task Force could be tasked to more deeply explore the issue. Florida could consider defining a specified digital asset class in law with appropriate rights assigned as Wyoming did as well.

These steps can position Florida as a leader in the cryptocurrency industry. We have the appetite for growth and technological development. All that is left to do is ensure that our policies reflect our values.

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