Written Testimony of Cameron and Tyler Winklevoss to the New York State Department of Financial Services NYDFS Virtual Currency Hearing, January 28, 2014

Mr. Lawsky, Mr. Alter, Ms. Filipakis, Mr. Syracuse and other members of the Department of Financial Services, we thank you for this opportunity to discuss our involvement in, and excitement for, the ongoing development of the Bitcoin ecosystem in New York. We want to thank you for your leadership in acknowledging the need to examine how state regulation can be applied to, or adapted for, virtual currencies or digital math-based assets (e.g., bitcoin), in a way that protects consumers, while promoting the growth of the Bitcoin ecosystem and its participants.

We have provided the below written testimony in response to your request dated January 17, 2014.

1) The feasibility of the Department issuing a 'BitLicense' specific to virtual currency transactions.

We believe the existing federal and state regulatory system provides a good framework for the regulation of certain participants in the Bitcoin ecosystem.

Through these hearings and the ongoing work of the Department of Financial Service, a well-conceived BitLicense could be developed that would build off of existing regulation and licensure of money service businesses and/or check cashing services. This BitLicense could adapt existing regulations to the specific needs and capabilities of Bitcoin industry participants.

2) What specific types of virtual currency transactions and activities should require regulation?

It is our strong belief that any regulation of the Bitcoin ecosystem must be carefully crafted so as to avoid over-burdening the average user or startup. There are, however, particular types of transactions for which regulation is appropriate.

We believe that it is appropriate to regulate businesses that allow for the purchase or sale of bitcoin using fiat currency, like dollars. Specifically, we believe that regulation that requires exchanges (or direct retail sellers of bitcoin that earn a fee or commission on such sales) that operate in New York to be licensed would be appropriate. We also believe that such regulation should include traditional Anti-Money Laundering best practices and similar policies.

Such regulation would accomplish the protective goals of the Department of Financial Services and similar regulatory bodies and would not impose extensive burdens on individual users or entities that engage in routine business. However, any regulation must be shaped carefully. Extending money transmission regulation onto parties who are not in the business of such money transmission, for example, would likely create onerous and commercially unreasonable licensing and compliance burdens on entities and individuals who lack the capacity and resources to comply.

3) Should entities that are regulated be required to follow specifically tailored anti-money laundering guidelines?

As we explained above, we believe that the imposition of anti-money laundering guidelines on exchanges or bitcoin retailers that operate in New York would be appropriate. The Department of Financial Services may elect to require the adoption of policies and procedures similar to those that the Financial Crimes Enforcement Network (FinCEN) has required of federally registered money service businesses under the Bank Secrecy Act and the USA PATRIOT Act.

It is our belief that a compliance sub-industry and culture of compliance among US Bitcoin companies will evolve and New York has the opportunity to help lead this process; however, we caution against the initial requirement of adherence to a specific form of anti-money laundering policies and procedures.

4) Should entities that are regulated be required to follow specifically tailored consumer protection guidelines?

We believe that one of the core components of the BitLicense process should be consumer protection. If the BitLicense applies solely to commercial enterprises converting bitcoin to or from fiat currency (as discussed above), then consumer protection requirements such as a) reasonably conceived capital requirements, b) identification of company principals and controlling interest holders on an annual basis, c) adherence to and publication of privacy policies and d) disaster recovery plans may be sensible.

Any such requirements, however, should consider and be adaptive to the fact that Bitcoin industry businesses, whether heavily capitalized or not, have to date been start-up ventures and that any such requirements should not strangle their ability to exist or grow both within and outside of New York.

5) Should entities that are regulated be required to follow specifically tailored regulatory examination requirements?

Annual examination requirements may, at this time, present too great a financial and other resource burden for Bitcoin companies based on their start-up nature (as described above). Annual examinations require the expenditure of legal, accounting and executive resources and can constructively shut down the regular operations of a start-up company for a period of days as preparations for and attendance at an examination occur.

A more reasonable solution may be the creation of an annual update letter to confirm to the Department of Financial Services that information on file with the department is current and to provide data or information that may be useful to the department.

6) The benefits and drawbacks of using virtual currency from a retail perspective.

The benefits of digital math-based assets for retail purposes have been discussed at length, including indirectly by the Federal Reserve Bank in a September 10th Public Consultation Paper entitled “Payment System Improvements.” The paper addressed digital math-based assets from the perspective of existing gaps in the US bank “payment system,” which mirror the perceived benefits of the Bitcoin payment system.

The decentralized nature of the Bitcoin network and its hardwired protocols, coupled with comparatively low transaction costs, have led some businesses, investors and financial institutions to invest in and/or use bitcoins on a commercial basis and thereby experience certain benefits. These include:

- *Efficient Remittance and International Wire Transfer*s.
- *Rapid Confirmation of Transactions*.
- *Reduced Chargeback Risk*.
- *Micropayments/Charitable Contributions*.
- *Bringing Financial Services to "Under-Banked" Communities*.

The potential drawbacks of bitcoin largely relate to the technical barriers to adoption. However, such technological barriers are constantly being alleviated through third-party service providers developing new products and services to make bitcoin more accessible. Potential retailers and businesses benefit from the contribution of service providers that facilitate retail payment gateways, such as Coinbase and BitPay (which offer to retailers the option to receive either bitcoin or US dollar equivalent value). Third party Bitcoin payment processors can calculate pricing and arrange for simplified adoption of bitcoin payments.

Furthermore, adoption of the Bitcoin payment system is not and "all or nothing" option for retail merchants and consumers. Bitcoin can be used as a supplemental payment system or transfer option. For example, OverStock.com recently included a Bitcoin payment option through service provider Coinbase, thereby becoming the first major US retailer to adopt bitcoin and, within 24 hours, received 800 bitcoin denominated orders having a total value of $126,000. This week, TigerDirect became the second major US retailer to accept bitcoin, using BitPay.

7) Pricing, volatility and security of the virtual currency market from an investor perspective.

From an investor perspective, pricing, volatility and liquidity are the core concerns relating to investing in bitcoin. The rapid increase in price is partially due to the increased acceptance and adoption of bitcoin amongst mainstream consumers. In addition, events in China led to an unexpectedly rapid increase, followed by an equally unexpected decrease, as the Chinese government clarified its policies on bitcoin.

One challenge relating to the pricing is a result of multiple exchanges that transact in different currencies. At this time, there are few reliable indications of the true value of bitcoin as different exchanges have different levels of volume and it is difficult to harmonize pricing between exchanges.

Notwithstanding the volatility in pricing, we believe that many investors are reluctant to further invest in bitcoin in part due to governmental uncertainty as well as security related issues. Security concerns appear to be related to sensitivity regarding how an investor stores bitcoin. As new products debut that provide investors comfort with the security of storage, we believe that new investors will be attracted to the asset class.

8) The future expectations and anticipated developments of the virtual currency market from an investor and retail perspective.

Investors, retailers and businesses in the Bitcoin ecosystem anxiously anticipate increased regulatory certainty, including tax guidance and asset classification guidance. Although we do not have any insight into how the Internal Revenue Service will view bitcoin, from an investor perspective we believe it should be viewed as a capital asset and taxed in a manner similar to that of other capital assets. A draft advisory opinion released, but not yet approved, by the Federal Elections Commission in November classified bitcoins as “something of value,” rather than as a currency. This determination, which has no authority over the Internal Revenue Service’s considerations, would serve as a corollary to a capital asset determination. Similar recent determinations have been made in Canada, Finland and Norway classifying bitcoins as assets or commodities, rather than legal currency.

Another major development will be the introduction of more sophisticated, capitalized and experienced Bitcoin service providers. Prior to 2013, few Bitcoin ventures appeared to have access to significant capital or investors with the transformative financial and networking resources.

We anticipate that bitcoin will be more accessible and more useful to the average user and investor in the coming months and years. In particular, we hope that the Winklevoss Bitcoin Trust for which we have submitted a Registration Statement to the SEC will help reduce the friction of investing in bitcoin. We are optimistic about the future of bitcoin and believe that government regulation and scrutiny will be better for bitcoin investors and businesses that participate in the Bitcoin ecosystem or accept bitcoins.