Ballard Spahr LLP

Subcommittee on National Security and International Trade and Finance

and

Subcommittee on Economic Policy

SENATE BANKING COMMITTEE

Hearing

"*The Present and Future Impact of Virtual Currency*"

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Testimony of:

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INTRODUCTION

Chairman Merkley, Ranking Member Heller, and the Members of the Subcommittee, I am Mercedes Kelley Tunstall, a Partner at Ballard Spahr LLP and the Practice Leader of our firm's Privacy and Data Security Group. My testimony today reflects my personal experience with the virtual currency industry and represents my own opinion. My testimony does not necessarily reflect the opinions of Ballard Spahr LLP or our clients.

Thank you for this opportunity to testify about the present and future impact of virtual currency. I work directly with multiple clients that offer their own forms of virtual currency. I also advise large banking clients on how to interact with virtual currencies as well as how to structure their programs and services as to avoid being treated as virtual currency. I have spoken extensively on this topic during webinars and other public forums, and I have been quoted frequently by the press. I will focus my remarks today on the important steps that the virtual currency industry and federal regulators should take in order for virtual currency to have a commercially viable future.

THE NEXT GENERATION OF VIRTUAL CURRENCY

In only a few short years, Bitcoin may have become the most well-known virtual currency today, but Bitcoin has also demonstrated a number of weaknesses that the next generation of virtual currency should be careful to address.

I. Bitcoin ≠ Integration

Bitcoin has built its reputation and structured its virtual currency around being both anti-government and anti-establishment. Although this reputation may be attractive to a certain type of consumer, the structure has limited, and will continue to limit, Bitcoin's adoption by a wider population. Due to Bitcoin's reputation, large financial institutions view the currency as being unreliable and therefore not able to meet their safety and soundness requirements. If a virtual currency could be reliable, then financial institutions may very well incorporate the currency as a solution to certain problems faced. For example, virtual currency could be attractive to large financial institutions if the fees associated virtual currency transactions, including the exchange fees, are lower than the fees accompanying other payments methods (e.g., interchange fees). The next generation of virtual currency should figure out a way to better align with existing payment methods, or virtual currency will never be able to move from a "niche" into the mainstream.

II. Virtual Currency ≠ Anonymity

One of the most frequently cited advantages of virtual currency is the increased privacy and anonymity associated with using Bitcoins. However, even Bitcoin is not completely anonymous as a public record of each Bitcoin transaction is electronically recorded. In order for the industry to continue maturing, the next generation of virtual currencies should dispel the perception that an important element of using virtual currency is the ability for an individual to engage in online transactions with complete anonymity.

In a transaction involving hard currency, the two parties to the transaction may not know each other, but in order for the currency to be handed from one person to the next, the two people must see each other and be in each other's presence (or have a proxy to do the same for them). This transaction is hardly anonymous, and yet many have compared Bitcoin transactions to cash exchanges between strangers and referred to such exchanges as being anonymous. Instead, the distinction is that such cash transactions can occur without being recorded by any financial system or government and without the involvement of middlemen such as banks. As such, Bitcoins, like cash, have been used in transactions to perpetrate fraud, money laundering, and other illegal activities. Unlike hard currency, however, technological solutions could be developed to track the digital exchange of virtual currency so that the transaction is not conducted through a middleman. Bitcoin and other virtual currency providers have a responsibility to prevent criminal activity and to comply with anti-money laundering and other laws. The next generation of virtual currencies must address the ability of individuals to use virtual currency to engage in illegal activities anonymously or the Congress, the federal agencies, or the courts may take action, which could result in harmful consequences to the industry's overall growth.

III. Bitcoin = Commodity or Bitcoin ≠ Commodity

Bitcoin displays some features that allow Bitcoin to function like a commodity, such as the self-imposed limit of 21 million Bitcoins and the volatility of the value of Bitcoins. However, Bitcoin does not presently comply with current securities or commodities laws and regulations. In order for banks to work with virtual currencies, those virtual currencies either need to comply with or protect against commoditization. Unless the next generation of virtual currencies can resolve the question as to whether virtual currency should be considered a commodity, the industry will remain characterized by volatility. Without further stabilization, mainstream adoption of virtual currency remains unlikely.

REGULATORY CERTAINTY

As the virtual currency industry matures, regulatory certainty will also be needed to ensure a future for this industry.

I. Legal Definition of Virtual Currency

The virtual currency industry would benefit greatly from guidance from the federal government as to the legal definition of virtual currency. Although it is clear from the Legal Tender Cases of the 1870's and 1880's that virtual currencies can legally operate in the United States of America, it is unclear as to what regulations could and should apply to virtual currency. The Commodity Futures Trading Commission and the Securities Exchange Commission have both examined Bitcoin-related issues and determined that there are times when the currency operates as a commodity/security, but beyond that, there is no existing legal framework that addresses the unique features and functionality of virtual currency.

II. Financial Crimes Enforcement Network

Existing FinCEN guidance has offered much-appreciated guidance for the industry and related players, but as the industry continues to mature, additional guidance will be needed on how to integrate virtual currency into the existing financial ecosystem, especially with regard to compliance with anti-money laundering requirements.

III. Electronic Fund Transfer Act / Federal Reserve Board Regulation E

Currently, consumer protections contained in financial regulations such as the Electronic Funds Transfer Act and its implementing regulation, Regulation E, do not apply to virtual currencies. Therefore, unauthorized transactions involving virtual currency have no recourse – once the currency is gone, it is gone, just as surely as when someone swipes bills from a wallet. Due to the electronic nature of virtual currencies, consumers may not understand the reasons for the disparate protections conferred on the use of these disparate payment forms. If consumers are unable to embrace virtual currency as a safe, effective means to conduct online (and even offline) transactions, industry growth will be stalled.

CONCLUSION

Thank you again for the opportunity to testify on these important issues. I would also like to express my appreciation to your staff for all their assistance in preparing for this hearing.

I would be happy to address any specific questions that the Members of the Subcommittee may have for me.

Ballard Spahr LLP

Mercedes Tunstall

Biography

Mercedes Kelley Tunstall is the Practice Leader of Ballard Spahr's Privacy and Data Security Group. She is also a member of the software and business methods practice team in the firm's Patents Group.

Ms. Tunstall counsels clients on compliance with consumer financial services laws, including unfair, deceptive, and abusive acts or practices, as well as the investigations, rulemakings, and proceedings of the Consumer Financial Protection Bureau and the Federal Trade Commission.

Ms. Tunstall has substantial experience working with clients to develop new financial products and services, including mobile wallets, virtual currencies, and prepaid cards. These engagements typically include negotiating agreements with technology vendors, reviewing technical designs, drafting customer communications and agreements, and advising on potential regulatory and privacy and data security concerns.

She also works with clients from a spectrum of industries on mobile and other e-commerce initiatives, privacy and cybersecurity issues, and the use of social networking sites for marketing, customer service, and crowdsourcing purposes.

Before joining Ballard Spahr, Ms. Tunstall was lead counsel for Global Marketing and Deposits at Ally Financial. She also worked in-house for Bank of America, where she managed all legal aspects of e-commerce, and at HSBC, where she managed consumer financial services litigation.

Ms. Tunstall was a Staff Attorney at the Federal Trade Commission, where she investigated and litigated the Commission's first Internet hijacking case, among other Internet fraud matters.