

# Consumer Finance Monitor (Season 6, Episode 5): How the New York Department of Financial Services (DFS) Regulates Virtual Currency, a Close Look with Special Guest Kaitlin Asrow, Executive Deputy Superintendent of Research and Innovation, DFS

Speakers: Alan Kaplinsky, Lisa Lanham, and Kaitlin Asrow

Alan Kaplinsky:

Welcome to the award-winning Consumer Finance Monitor Podcast, where we explore important new developments in the world of consumer financial services and what they mean for your business, your customers, and the industry. This is a weekly show brought to you by the Consumer Financial Services Group at the Ballard Spahr law firm. I'm your host, Alan Kaplinsky. I'm the former practice group leader for 25 years, and now senior counsel of the Consumer Financial Services Group at Ballard Spahr. I'm very pleased to be moderating today's program.

For those of you who want even more information about the topic we'll be covering today, or virtually any other topic that we cover on our weekly podcast show, don't forget about our blog, [consumerfinancemonitor.com](http://consumerfinancemonitor.com). Goes by the same name as our podcast show, except that we've hosted our blog since 2011. We started our first publication on the very same day that the CFPB got stood up on July 21 of 2011. There's a lot of relevant content there.

We also regularly host webinars on subjects of interest to those in the industry. To subscribe to our blog or to get on the list for our webinars, please visit us at [ballardspahr.com](http://ballardspahr.com). If you like our podcast, please let us know about it. You can leave us a review on Apple Podcasts, Google, or whatever platform you use to get your podcast shows. Also, please let us know if you have any idea for other topics that we should consider covering or speakers that we should consider as guests on our show. With that introduction, it's my pleasure, first of all, to introduce our very special guest on today's program.

Our special guest is Kaitlin Asrow. Kaitlin is the executive deputy superintendent of research and innovation at the New York Department of Financial Services, or for those of us in the industry, we refer to the Department as DFS, and everybody knows what we're talking about. Kaitlin is responsible for economic research, innovation policy, and virtual currency licensing or chartering supervision and examination.

Prior to joining DFS, Kaitlin served as a senior policy advisor within the Federal Reserve system, specializing in fintech, data governance and management, data privacy, and artificial intelligence. She's a recognized leader in financial services, innovation, and policy, with experience in entities supervision and research design. Kaitlin has authored multiple papers and books on data policy, including an evaluation of data protection and data rights in the United States, and a review of open banking. Kaitlin received her master of public policy from the University of Chicago and her bachelor of arts from Stanford University. Kaitlin, a very warm welcome. Delighted to have you on our podcast show.

Kaitlin Asrow:

Thank you so much, Alan. I'm really happy to be here and excited to talk about what we're doing at DFS.

Alan Kaplinsky:

We know that the New York Department of Financial Services, or we'll call it DFS, has been highly focused on virtual currency regulation, after releasing its BitLicense in 2015, as a way to regulate businesses that provide customers with the ability to buy and sell cryptocurrency in the State of New York.

The state has actively monitored the growth of virtual currency businesses over the past eight years or so, and has an established, yet dynamic licensing and regulatory compliance schematic for the industry. We're excited to speak to you today about all the Department has seen over the past several years, how it's reacting to recent events, like the FTX and Coinbase issues, and the new guidance that the Department released just today regarding custody of virtual currency assets.

Before we get into the questions I have for you Kaitlin, let me also introduce my colleague, Lisa Lanham. Lisa is a partner in Ballard Spahr's Consumer Financial Services Group and the Mortgage Banking Group, and she co-leads the firm's Fintech and Payment Solutions team. Her practice focuses on financial services matters related to state licenses and federal approvals that are necessary to conduct business for a variety of asset classes and market participants.

She often works with money transmitters, crypto companies, and companies utilizing blockchain or digital ledger technology to help develop products, mindful of state licensing and regulatory compliance requirements, and to obtain and maintain any required state licenses and approvals that are necessary to engage in business. She also helps these types of companies complete audits and examinations, explain difficult disclosure issues, report changes of ownership in executive management and qualifying individuals. A very warm welcome to you as well, Lisa.

Lisa Lanham:

Thank you, Alan.

Alan Kaplinsky:

Okay. With that, with those introductions out of the way, let us start by setting the baseline for our discussion. What I'd like to know first, Kaitlin, is how does New York State and DFS regulate virtual currency?

Kaitlin Asrow:

Yeah, absolutely. I think the first thing to start with is just the unique structure that I think DFS has established to regulate virtual currency business activity directly. As you said in the introduction so kindly, I come from the federal side, where a lot of the focus that I had was really regulating innovation through banking and through the banking system, but in New York, we're regulating the entities directly. We do that through a number of, I would say, legal and regulatory structures.

First we have, at this point probably, the famous BitLicense. This is a licensing system. It's called Part 200. It's a regulation passed under our Financial Services Law. This is really modeled after banking oversight, but again, it's specific to virtual currency and it's quite broad. It defines any virtual currency business activity conducted in New York State or with New York consumers has to have this specific licensure. Then, some of the risks and controls there are specific to virtual currency in particular. This license does not allow for an entity to touch fiat though.

For example, if an entity wants to transition money from fiat currency to virtual currency, it would also have to hold a money transmission license. Money transmission is the common licensure in other states, for example, where virtual currency might be permitted and how it's overseen, but here in New York, we have two separate licenses. One for that traditional money transmission of fiat, and two, for the virtual currency activity under the BitLicense.

We also have a limited purpose trust charter. That is a banking entity, which we have allowed to do specific virtual currency activities in New York State. This trust charter is limited by its very definition, by its name, limited purpose trust, to do only a subset of banking activities. For example, we don't allow them to take deposits from the public, as they typically don't have FDIC insurance, so we consider them eligible for that. We limit their activities.

These entities also have fiduciary powers, as defined under New York State law, and because they are banking entities, they don't separately need a money transmission license. We see a lot of different entities who come for a charter versus a license. Maybe they hold both and split up their activities, let's say a custodian activity in a trust charter, and other kinds of exchange activities, and BitLicense really is depending on what the entities want to do.

I'd say BitLicense and trust charter are the two primary ways we supervise license and chartered activity. I also will just flag that we do allow our banking entities, our full-scope banking entities in New York State to conduct virtual currency activities without seeking a separate charter or license, but they have to get explicit approval for the activity from the superintendent.

You'll see guidance available on our website on how a bank that might be interested, that's chartered in New York, might go about engaging as well. I think this gives us a lot of different tools, and honestly, hopefully is pro-innovation because businesses can pick what chartering or licensing type is most appropriate for them.

Alan Kaplinsky:

Kaitlin, what about savings and loan associations? Are they treated like commercial banks in that they don't need a separate license, a BitLicense, but whatever a commercial bank could do in this area, they can do if they're state-chartered S&Ls?

Kaitlin Asrow:

Yeah, so I think we would have to go on a case-by-case basis. In terms of the specific types of charters that we've allowed to come in with the expectation of doing virtual currency activity is the limited purpose trust charter in the banking law and then the BitLicense. If any other type of banking activity wants to engage in that activity, they would have to come to DFS for explicit approval. So far, that has been in these larger, full-scope banks, but it would have to be case-by-case in anything beyond, again, the limited purpose trust charter.

Alan Kaplinsky:

It would cover not only entities that are banks, I should say, that are chartered under New York law, but what about out-of-state, state chartered institutions? They need to get approval as well?

Kaitlin Asrow:

Yeah, so because of how important it is for us to keep New Yorkers safe and make sure that the integrity and the work that we've put into this supervisory structure is maintained, to be frank, we're quite cautious about out-of-state activity in New York State. We do, typically at a minimum, seek for ourselves to have rigorous oversight over those entities.

I think that there is, obviously, a multi-state reciprocity concept that has happened in state banking since the advent, and as we think about preemption and federalism. That being said, I think we can all acknowledge that virtual currency is quite different than the standard business of banking, potentially, that those systems were initially intended for.

I think we, again, take it case-by-case to make sure that we have the sufficient oversight in New York. Those entities that come to us in New York and have that kind of rigorous application process, go through the oversight, don't then have someone who's coming in from another state and gets to do all the same activity. We do always apply the same rigor, regardless of where they're coming in from.

Alan Kaplinsky:

Right. Lisa, do you have anything to add to what Kaitlin had to say?

Lisa Lanham:

In dealing with the Department on a number of these license applications, it becomes a bit obvious that the checklist, while robust for all the things that you need to vet a company, is sort of a floor and not a ceiling, so to speak. With everything going on and seeing the recent release of the Coinbase settlement, reading through that, if you looked at it carefully, you can almost read the tea leaves here and see what the Department might be looking for in certain areas for regulatory compliance. I was just curious if you could maybe talk on that a little bit and let us know whether you agree.

Kaitlin Asrow:

Yeah, absolutely. I will flag, Coinbase was a public settlement that ... I am responsible for, as Alan referenced, licensing and chartering, so conferring that initial approval to do the activity in New York State, ongoing supervision and examination. Then we have an entire enforcement division at DSF, which I'm able to refer to if an entity is found to be noncompliant with our law, to levy those direct penalties, and so that's what you see with Coinbase. I do agree, what was uncovered and what was key

in consent orders ... I would honestly encourage the reading of those for any regulator who puts them out. They are a wealth of information.

We work very hard to articulate the specific issues with the compliance, and remediation that's expected in those is, I think, an example of where we're focused, the rigor that we expect from our entities and from their compliance systems, so absolutely take a read. I will say something that's been fascinating and I think is important to always note is there is no ... While we have checklists out there, as Lisa said, it's a floor. There is no checkbox or set that you can just package something up, and send it to us and you'll be automatically approved, because every business is different.

Really it's about, how did you tailor your compliance programs, your oversight, your risk management to the risks and your business activities? Presumably, we hope that every business is different. You have a unique niche. You're serving specific customers. Your risk profile might look different than your competitors, and that is what differentiates you. Your package then, necessarily, has to look different from someone else who's submitting to us.

Alan Kaplinsky:

You may have answered this question already, but I just want to nail it down, Kaitlin. What role does guidance serve in your regulation and oversight of virtual currency?

Kaitlin Asrow:

Yeah, absolutely. Also, one thing I just want to note before we get into guidance as well, which I think is a nuance that is important, especially in the virtual currency space is ... Many of you might be familiar with this, listening to the podcast. DFS is what I would call a prudential regulator. Virtual currency is also regulated by markets, regulators, securities, commodities, for example.

I will note that DFS is regulating the entity itself, the safety and soundness, and stability of the entity, not necessarily the product. Meaning, we do not define whether something is a security or commodity. That rests with the AG in New York, with the SEC, and the CFTC. What we do require is that our entities are always compliant with law, and so it's the entities' responsibility to make that determination with their market regulator with regard to where they need to register or comply their specific products, and then we make sure they're safe and sound in the production of those products. Just put a pin in that.

With regard to guidance, so I think I'll take a step back from my division in research and innovation for a second because something that, honestly, brought me to New York that I find quite fascinating is that I get to lead a division where policy sits right next to a supervisory team. I think that's really helpful as you develop clear rules of the road, clear and transparent articulation for how we interpret our own regulation. That's how I think of policy in a regulatory space.

Being able to lead these two teams means that I'm able to meet the expectations of our current superintendent, which is clear and transparent communication to industry on what we expect in terms of compliance. Now, we can always debate prescription versus principles-based regulation. Some could say issuing guidance is towing into being a little bit too prescriptive in our expectations, but I think this industry is still nascent. It's still learning that culture of compliance, and so it's our hope that by providing a little bit more meat to the bones of our regulation, an entity knows what our expectations are. That's really formally what guidance is to DFS.

We're not setting new rules. We're just articulating how we interpret our existing regs and helping an entity comply with that. These conversations and these requirements, I will just say, especially with the guidance that was put out this week and such, it's not new. These are expectations we have always held our entities to in the confidential supervisory relationship. What we're trying to do is level that up and make it transparent for anybody new coming in and for other regulators, honestly, to refer to.

Alan Kaplinsky:

Yeah, sure. As I mentioned during my introductory remarks, Kaitlin, just today you released guidance concerning custodial structures for customer protection in the event of insolvency. What are the key takeaways consumers and the public should know about this particular guidance that got issued?

Kaitlin Asrow:

Yeah. The first thing I'll say is us releasing this guidance, I know a lot has happened in the crypto winter, and downturn, and news cycle. Ironically, the guidance development process, as I'm sure you all know being in the legal field, is quite long. We spend a lot of time editing and going over text, and meaning of words, and preparing for this. This guidance was in development well before this crypto downturn.

There's no indication that any of our entities are unstable, and there's no reason or context behind this besides, again, this effort around transparency of the expectations we have always had. We do everything we can, as a prudential regulator, to ensure the safety, and soundness, and stability of our entities. That's the floor that we're operating on in New York State. We're mitigating insolvency, constantly, through our regulation. What we want to also demonstrate, and I think it is, despite the fact that the timing is more ironic than planned, this period does demonstrate the importance of how we structure the custody requirements for our entities differently than how they are sometimes structured in the market, which has created issues for consumers.

The guidance is not intended to signal anything in terms of the market. Our entities are strong and stable. It's about letting everyone know that the custody structures that we have stood up, we think put the assets of the customer in a different place than they could be interpreted in other jurisdictions. In particular, those assets, the ownership stays with the customer, so if someone were to become insolvent, there's not this debate with whether those assets are actually the property of the entity that was holding them.

Obviously, it's something that we would never expect in our banking relationships. We would expect that if I put my money with the bank, obviously, we have insurance, and a lot of protocols, and regulations with that, but we wouldn't expect then that becomes bank A's property. That's what we're trying to model it here.

I think one thing that I'll highlight is that something that really helps us in defining these custodial structures in New York is that we do not allow for rehypothecation. We don't ever have an entity who's basically choosing to take customer assets and lend them back out at their own discretion. When an entity does that lending, it puts the assets in a creditor capacity versus what we call bailment capacity. We are just making it very clear that any custodian regulated by New York is expected and does keep the assets in a bailment capacity, meaning again, they're the consumer's, not the entity's.

Alan Kaplinsky:

Are you allowed, under this guidance, to commingle accounts of customers?

Kaitlin Asrow:

Yeah, so there's, I would say, three core tenets of the guidance. Again, these tenets aren't new in terms of what we require of our entities and have required, and they're not new for general custodial structures in the larger context of other financial services that we see.

The first key pillar of this guidance is that the custodian's expected to separately account for and segregate customer virtual currency from corporate assets. There does have to be a clear, I would call it physical segregation, plus books and records between entity corporate assets and consumer assets, but a custodian may commingle a pool of just consumer assets, as long as the appropriate books and records are maintained that says, "This is Alan's bitcoin. This is Kaitlin's bitcoin. This is Lisa's bitcoin." The key thing is really corporate versus customer segregation.

The other key pillars are that the title of the virtual currency asset must remain with the customer and not transfer to the custodian. This is key with this kind of bailment versus creditor capacity here, that the title isn't transferred for an entity to then act upon it. It's really staying with the customer, and the entity is just the custodian.

Again, this is key because this is what didn't happen, obviously, in cases like FTX, where those assets were then taken by the entity and used at their discretion to do things with, and then because that was done, those assets ... It's up for debate, and obviously, now there's been precedent in the courts that say once an entity is doing that kind of activity, arguably, those are the company's assets, not the consumer's.

Then the final key pillar is just flow-down. Some custodial arrangements are common in this space, so we just want to make it clear that you might have, as a customer, a relationship with one entity, but the actual custodial activity is being performed by a third party. That third party, if it's being used, again, by one of our regulated entities, has to comply with this same expectation.

Lisa Lanham:

Yet, the time is just ... I know you had said it's not in response to anything. This was in the works a long time ago, but at the same time, the timing is just, it almost couldn't be better for you guys and for us. A lot of what I do, we're trying to figure out, what does the crypto world look like after all of this? Because there are so many issues coming up with a number of other state regulators, especially focusing on rehypothecation.

Your guidance is something that I can see other state regulators reasonably looking towards to say, "This is good. This is something that would have solved a lot of issues for us, if we could go back in time and fix that."

Kaitlin Asrow:

Yeah. I think I'm just, again, more on the innovation side and the thought experiment with regard to virtual currency relative to our existing structures. Fractional reserve banking and virtual currency just might not be the same thing, and that model maybe shouldn't pour over to virtual currency in terms of this idea that you take assets in and you lend them back out to another customer, and that's how you make money. Maybe it is, but I will say, I think one of the key things why rehypothecation is not allowed in New York ... I don't understand, with the volatility and the interconnections between these assets, how you can appropriately capitalize that business model, and so this really, I think, puts our entities in this clear space of doing activities that are safely regulated, have structures around them to make sure consumers are protected.

There is space to think about, how are there different business models and monetization paths for virtual currency? We're just, definitely in New York, not ready for that to be lending-based, and I think we've seen good reason for that.

Alan Kaplinsky:

Were you able, Kaitlin, to get a comfort under the federal bankruptcy laws that the structure that you describe in the guidance, you're going to be able to accomplish the objective? I mean, what is your level? Is your comfort level pretty high?

Kaitlin Asrow:

That's a great question. I will note the two, again, the chartering versus the licensing regime. Under New York State law, DSF does have resolution authority for our banking entities. We have discretion regarding resolution and any kind of insolvency proceeding with regard to the assets of the trusts and with any banking entities. That's not the case for our licensees. That rests in Chapter 11 and with the bankruptcy court.

Now, we cannot intercede. That will be always be the determination of the courts with regard to their determination on where these assets sit. Though it is our hope, based on significant research, and precedent that we've read, and other regulations, again, with like custodial structures that these are tenets that should not be new to anyone who's, again, holding assets on behalf of others. The not commingling, leaving title with the customer, clear disclosures in that legal agreement with the customer, we think these would help based on our assessment in a bankruptcy proceeding.

This is all so new, so it is also our hope that a bankruptcy court might take our intent into consideration. By putting it out there, there is an element as well of us participating in the conversation that a court might go through in this, but we can't, obviously, predict or have sway over what an individual bankruptcy court would decide, at least for our licensees.

Alan Kaplinsky:

How does the guidance that has been issued in New York, how does it make New York crypto companies different from those in other states?

Kaitlin Asrow:

Yeah. I think that we feel that it really differentiates them in terms of that oversight level that customers are aware that the entities have. I think there's obviously a clear acknowledgement and narrative that there are businesses that New Yorkers cannot access in New York, and that is because they have not received an application, or received a license or a charter yet. From our perspective, we think that's good. There are the entities that we've seen have major crashes, have not been permitted to do business in New York, and I think that has gone a long way in keeping New Yorkers safe. Then, the entities that are doing business in New York have that safety and soundness, that prudential oversight and regulation.

I think there's a lot of different ways, from the actual rigorous application process, to not allowing rehypothecation and this lending activity to the entities themselves. Whether it's a custodian you're going to go to, an exchange you're going to use, some way to convert your fiat to virtual currency, you can be confident, as a New Yorker, that those entities have our oversight. I think enforcement actions like Coinbase, while obviously that can be read in a variety of different ways, I think that it shows that we are watching them, that we are constantly monitoring them, and pushing them for improvements that customers will benefit from.

Alan Kaplinsky:

Yeah. What kind of feedback, Kaitlin, have you received from other regulators, both either at the state level or federal level, and also the industry at large?

Kaitlin Asrow:

Yeah. We've had really positive and, I think, have fantastic relationships with our other regulators across federal, state, and honestly, international levels. It's common practice, again, given that I've worked for many of these different entities as well, to share best practices, to share what we're doing. I always share the guidances that I'm working on with my fellow regulators, as they're in development, to get their buy-in and feedback.

Alan Kaplinsky:

Is that done through the Conference of State Bank Supervisors, or is it less formal than that?

Kaitlin Asrow:

I would say, absolutely, CSBS has a large role in state coordination. I would say because of DFS's unique position with regard to virtual currency, there aren't the same kind of tried and true paths that CSBS, for example, has established with regard to banking coordination or money transmission coordination. That being said, they're being established. Right now it's, honestly, our bilateral relationships with every prudential federal regulator, with international regulators from the FCA, to the Monetary Authority of Singapore, to specific states like, I think Lisa knows California quite well, that also has very active innovation spaces.

We are just talking to them, having check-ins with them, and sharing conceptual guidance at every stage. The feedback has been really positive, and we feel like this is new. It's more heads are better than one, so we're actively coordinating. I think the benefit of being in New York in particular and being in the state system is we get buy-in, we coordinate, we communicate with our other regulators, but at the end of the day, we have to be responsible for New Yorkers.

We go out, we put our guidance out, and we do the regulation, rather than waiting until, let's say, everyone in the United States has agreed on how we're going to regulate this space and who's going to do it, which might take some time. I think we're in the position of trying to be a first-mover, trying it out, having lessons, and coordinating as much as possible.

Alan Kaplinsky:

What is DFS doing to ensure accountability and compliance with the new guidance?

Kaitlin Asrow:

As I think I mentioned earlier, our guidance is always based on the current accountability and compliance that we expect from our entities. We have a full-scope supervisory team, applications team, examination teams that are constantly checking for compliance with our regs, and when those are violated, that's where we get into enforcement actions.

When new guidance comes out, really, that's just the end of a long-standing process in which we are monitoring and overseeing our entities for the compliances that we expect. For example, this is all about custodial structures, so we're reviewing those during the application process. We're also reviewing them as a matter of ongoing supervision. If an entity wants to onboard a new sub-custodian, a new partner, or they want to experiment with new technologies, multi-party computations, new key management techniques, they're coming to us, we're having discussions, we're saying, "Does this comply? Are you going to maintain the segregation of your proprietary assets from your customer assets? Are you ensuring that the disclosures are appropriately cycled down to the consumer?"

All those moments are chances for us to engage and make sure that our entities are compliant. Then, always, exams. We have a cadence of exams that we hold every entity to. We can then go and do spot exams. If an entity is launching a new product, they want to become a custodian, then the next exam, if we approve that activity, is obviously going to focus on their custodial structures and how those are appropriately created to comply with these types of expectations.

Lisa Lanham:

Just to add, quickly, Kaitlin, we've discussed this leading up to this podcast. A lot of clients out there are a little scared of DFS because you're such a big regulator. One thing that I've always known and appreciated about my relationship with DFS is that you guys really are willing to get on the phone, or engage with your licensees or applicants about things that they have questions about.

Obviously, you can't answer every question for every eventuality, but I would just say that I think another point to be made is, reading between the lines of what you're saying, is that if you're somebody who has a question about whether or not something you plan on doing would put you out of compliance with the guidance, it would be important to proactively reach out to your DFS contacts, either on your own or through your legal counsel, really to engage in that discussion, and that DFS would be open to it.

Kaitlin Asrow:

Yeah. I think something that I first learned as a regulator coming into the space many years ago, which I think was conceptually new to me as an outsider who was previously a consultant and a researcher, and just saw regulation from that perspective, is that really, it's a relationship. It's a relationship that you enter into as a licensee, as someone who has a charter with your supervisor, and that relationship is one of communication. That is fundamental. It's about, "I'm going to tell you what's going on."

It's my hope then that the regulator is not there to always tell you no, but to help you provide another line of defense. Lines of defense are common in banking. You have your internal audit committee, you have different kind of structures, but we're all checking each other. Ideally, your regulator is there to help you do your services in a better, safer, sounder, more resilient way. That means you're around longer, you're providing better services to your customer, and that is an advantage to you as you grow your business. I think that's the, I think the kind of, we can call it a culture of compliance, but honestly, it's just that mindset that I think virtual currency needs to be introduced to, that it's not ideally adversarial, but rather a confidential, supervisory relationship that you enter into.

I have points of contact for every one of my entities. I, as a leader, am committed to communication, transparency, talking to our entities. Obviously, staffing is hard. We're in a very tight labor market, so everyone needs to be patient with the staff time I have to respond to every single thing immediately, but I think it's that relationship that's key.

Lisa Lanham:

I think there's a really excellent point to be made in the sense that sometimes, it can feel adversarial because you need to apply, and this regulator is looking over your shoulder and seeing what's going on, but at the end of the day, both the regulator and



the industry, we're both on the same side, and that's the side of the consumer. It's important, I think, really just to emphasize that this is a relationship, and for everything that could go wrong, there's a lot that could go right by talking to your state regulators.

Alan Kaplinsky:

Let me ask you a practical question, Kaitlin. It comes to mind because I recall, a few months ago, seeing something come out of the CFPB where they were actively soliciting experts in the fintech area. Not lawyers. They weren't looking for lawyers, but they were looking for maybe what you would call technocrats, people who really talk the talk, understand the language, understand the industry thoroughly, maybe could even mine for bitcoin if they had to.

I'm just wondering, New York has been at the vanguard of regulating the crypto business for a while now. How are you able to recruit the people that have got the experience and the background that you need in order to effectively regulate and supervise?

Kaitlin Asrow:

Yeah. Well, so if you're going to ask me what the hardest question on this podcast would be, I don't know if anyone would have guessed my pick would definitely be recruitment, but it really is the hardest challenge that I think any regulator faces in the innovation space. I've been in the regulatory-innovation intersection, though I'm relatively new to virtual currency in my career. All things being relative, really, I think there's a number of different ways that we approach it.

First, we are doing everything from finding young, hungry folks at the early stages of their career, to bringing folks out of retirement that we know, who are banking regulators and such, who are interested in doing this. I think we've found really good people who are at either end of their careers. At the end of their career, meaning they've either been in private sector or in public sector and have made their mark or raised their families, and don't need to focus so much on maybe the income that a, let's say, private sector, innovative company can give them, and are willing to come to the state, or to honestly, any public service entity in that salary band. Or young folks, who are trying to establish themselves and really understand the fundamentals.

It has been quite challenging to get that kind of mid-career professional who's building up to come, but we're working on that with regard to various growth paths and training opportunities. I will say, my selling point has always been, first of all, in this kind of relationship context, I talk to my staff a lot about, we can be passionate about innovation too, and that's a part of the market that we're participating in.

One of the key things that I did when I first started is, under very specific disclosure, recusal, and guardrails, I allow my staff to hold virtual currency themselves. Again, subject to a lot of constraints and potential recusals, but that was fundamental and something I didn't see in other regulators when they just kind of outright banned the holding or the participation in the market. I felt like I wanted my staff to understand it, to be able to go in, see how an exchange works, see how a wallet works. A lot of them are passionate about the space, and I think that that's positive, so that was one tactical step I took.

Then I think we've talked a lot, internally, about I can hire regulators or examiners and train them in virtual currency, or I hire virtual currency experts and I train them in the business of regulation. We do a lot of cross-training that way to try to, I would say, level up our staff to where we want that hybrid person who knows virtual currency deeply, but also knows what an exam is, what is a framework for reviewing an entity on-site? Those are some of the tactics, but it is not easy, and I will not pass up a chance on a podcast to shout-out all of the open positions that we have on [dfs.ny.gov](https://dfs.ny.gov) that please, have anyone interested look at.

Alan Kaplinsky:

We'll waive any right we have to commissions. That's fine. Whoever you're able to recruit is fine because I honestly think it's something that the industry strongly supports. Because if you're involved in a fintech kind of industry, you want to be communicating with supervisors on the other side that are knowledgeable about your business. It's important, so I think it's a win-win for everybody.

Let me ask you this. We've talked about the guidance that you issued today and what you've done for the past eight years, what DFS has done. What's the next step for the Department?

Kaitlin Asrow:

More of the same. I think the goal is going to continue to be, well, first, hire, improve. I do think the superintendent has been very clear. We've put out an initiative called VOLT, where we're very much focused on not only staffing up, but becoming more efficient ourselves with regard to our process, with regard to all of the feedback that we've heard from the industry and we hear in terms of timelines, lack of clarity. We're working to address those, and that is one of the key reasons why I'm here in New York.

Another thing is that transparency. You'll see more guidance for us. I think some key areas we're focused on are capitalization requirements. We do require our entities, not only holding custody we expect always to be one-to-one, so again, Alan deposits his bitcoin. We expect our entities, and require them to always hold one bitcoin for Alan. In addition to that, we require them to keep capital on hand, call it regulatory capital, in the event of any kind of instability in the market, to mitigate against cybersecurity risks, BSA/AML transaction risk. We will be issuing guidance as we go forward on capital and how we calculate that amount you have to hold for us to make sure you stay stable.

Consumer disclosures. I'm very passionate about how we communicate directly with consumers, so I think you'll see more from the Department on how we expect our entities to structure disclosures, to talk about the risks for consumers, and when is that moment of engagement on consumer interaction, and potentially us even communicating with consumers? I think that's important and that's a priority for the governor as well.

NFTs, DeFi, these maybe are less buzzy with everything that's going on, but I think still something important for the Department to address. I think you'll see more from us with regard to guidance on our regs. Then I will continue to, hopefully, push out FAQs and guides with the caveat always that any checklist I put out, I think as Lisa said better than me, is a floor, not a ceiling. That's not going to guarantee compliance, but just some common deficiencies that we see, issues that we see. I will continue to try to push out as much as I can for the market to refer to.

Alan Kaplinsky:

Do you think, Kaitlin, from the consumers' standpoint that you can adequately protect consumers through a disclosure regime? Or do you think that this is such a highly technical area and a very complex area, that a lot of consumers don't really understand. I guess, one of the worries that I have is that every once in a while, I'll talk to some of my ... I have three kids. They're grown up, they're adults these days, but they'll talk about friends of theirs that are dabbling in crypto, and some have made a lot of money. I really worry about people getting involved in things that they don't thoroughly understand.

I guess, what I'm driving at, is disclosure the answer, or do you also have to impose some type of suitability requirements so that there are consumers that just shouldn't be involved in the crypto end of things?

Kaitlin Asrow:

Yeah, this is a topic near and dear to my heart. I think I mentioned, I'm very passionate about consumer protection, generally. If I think, "What is consumer protection?" I don't think disclosures are consumer protection because they put the onus, frequently, on the consumers to read, digest, and make a decision. That being said, I think in the regulatory space, they are commonly couched, and even in our own regulation, consumer protection is defined as disclosures.

We also have a marketing and advertising regime in terms of transparency and not having anything deceptive in your communication, and then we have complaints processing. I, personally, as Kaitlin, don't consider disclosures consumer protection or think that they're sufficient as a form of protection, honestly, in a lot of financial services. I'm not just talking about virtual currency.

Financial services is opaque, it's complex. I think that's why you've seen a history in this country of regulation E, of FCRA, of all of these protections with regard to bias, with regard to discrimination, and liability protections for consumers in different contexts of financial services. When I put out guidance, I can't write new regs with guidance. Guidance is always an

interpretation of the existing letter that I have. Existing letter I have is disclosures, marketing and advertising, and complaints. That is what we will focus on from a guidance perspective, on how an entity can comply with our regulations today.

I am more than open, and I think our Department will engage in a conversation with the market, with other law firms, with many people on, how could we think about implementing additional protections, consumer protections? Maybe akin to liability limits, or things with regard to discrimination, but that would need to be much more of a consultative process and go through our regulatory development, and public comment and things before we would be able to release it because it's just not in the text of my law today.

Lisa Lanham:

It does feel very like caveat emptor right now, without a lot of disclosures because to your point, Alan, it's complicated, and there are people out there who trade in crypto all the time, and they're not exactly sure what rehypothecation is, or why that might be risky to them, or things like that.

The concept of disclosures, it's not new to us. In mortgage, we have housing counseling requirements for certain types of products, so the way that you're describing it, it almost seems something like that, where it would be educational. The point of the disclosure would be to be more educational so that people know what they're stepping into.

Alan Kaplinsky:

Right, right, right. Let me turn to really what, I guess, will be the final subject I wanted to get your reaction to, Kaitlin. That is, Superintendent Harris recently said that she'd like for there to be a framework, nationally, that looks like what New York has put together because of, these are her words, "Calamity in the market." Was Superintendent Harris referring to the recent FTX collapse? Also, has DFS engaged with federal regulators about instituting a national framework?

Kaitlin Asrow:

I'll recall the early conversation on coordination and say, absolutely. We're in constant communication with our federal counterparts in terms of regulation on both the prudential and the market side. I think we always acknowledge here at DFS that our jurisdiction is confined to New York State and New York State consumers. We do feel there's a need for a national framework, so all consumers can honestly have the protection that New Yorkers have. We do feel that our framework has impacted consumers nationally, just because if we require an audit committee or updated cyber protocols, those tend to not be confined to just an entity's New York customers, but are generally a process and a procedure upgrade.

What we are focused on is providing technical assistance to other regulators, and honestly, federal legislature whenever they need us with regard to what has worked and what we would recommend in terms of a broader regulatory framework, with the caveat always that we are a state regulator and we feel that there should not be preemption in this space, from a federal perspective, and just like a dual banking framework, entities should be free to choose where their kind of chartering or licensing system works best for them.

I'll say, historically, non-bank licensing has been the purview of the states and has worked well, so we would expect that to continue. We have a lot of experience with this coordination to make sure there is some kind of federal overlay and we can have a comprehensive view. So, absolutely, constant coordination with our counterparts, both regulatory and on the legislature. We've been here doing this work for almost 10 years, and I think we're looking forward to continuing it.

Alan Kaplinsky:

Yeah. Are there, in terms of what's going on in the other states ... I know we don't have time to do a roll call of the states and see what they're each doing. My guess is most of the states are not doing a heck of a lot. Are there other states that are anywhere close to where New York is in terms of regulation and supervision in this area?

Kaitlin Asrow:

Yeah, so I'm never one to comment on, at least, where other states are because I know how complex it is and how dynamic the process is. I will say, our framework in New York, we do feel that it's unique in terms of its rigor and the breadth that it gives us in how it's structured. I know from our coordination, other states are focused very heavily on this. I know are some are licensing through money transmission or licensed lender.

I think the challenge is they're using existing frameworks, which aren't fit for the activity, and so they're a bit struggling on that kind of square peg, round hole, or whatever the analogy is. It's a lot of work to stand up an entirely new regime, so that's where we're providing, I think, technical assistance and trying to work with them as we can, but it's a rock and a hard place when you have existing structures versus building something totally new.

Lisa Lanham:

I was about to say, I think, shameless plug for some of the work that we do with other states, but we do talk to other states quite frequently. The existing framework that they work within is oftentimes an issue because the foundational question is, what is money? I have to ask people, "What is money? Does what I'm dealing with, constitute money?" It's a challenge, and it's very nuanced, and does require a lot of discussions and coordination with state regulators.

Alan Kaplinsky:

Yeah, yeah. I'm wondering, Lisa, from your experience as a practitioner ... I know that Kaitlin doesn't want to be in the position of comparing what New York is doing to other states, but my guess is New York is really the vanguard here. Am I right?

Lisa Lanham:

New York was certainly the first state that was on my radar in my career for virtual currency, just because of the BitLicense, and Benjamin Lawsky, and all of that stuff. It was very obvious what was happening in New York. Since then, a lot of other states have enacted specific regulation, either for a virtual currency license like a Louisiana, or some other states that are saying, "We just think that this is money." Or, "The way that you're doing this, because it's this hybrid, fiat, crypto transaction, that's the threshold for us."

There's a lot of activity out there, and I do think that the guidance that New York is coming out with is really going to impact how a lot of other states are looking at things, especially with the crypto winter and everything that's going on.

Alan Kaplinsky:

Yeah, yeah. Okay. Well, we've pretty much drawn to the end of our discussion today, but before we say goodbye to everybody, just wondering, first, Kaitlin, whether you have any final points you want to make that perhaps we didn't already cover.

Kaitlin Asrow:

No, just a huge thank you to both of you and this team for the fine conversation, and for highlighting the work we're doing. I think more clarification is good, so I know you are actively supporting us in that as well.

Alan Kaplinsky:

Absolutely. Lisa, I'll give you the last word in.

Lisa Lanham:

Oh, I appreciate that.

Alan Kaplinsky:

Other than my last word.

Lisa Lanham:

Thank you. No, I was just going to say, we really value our relationship with DFS, and just couldn't thank you enough for taking the time to speak to us. It's been really informative. I personally look forward to what's to come, and talking to you more about it all.

Alan Kaplinsky:

Yeah, yeah. To make sure that you don't miss our future episodes, let me remind you again what I said at the beginning. Subscribe to our show on your favorite podcast platform, Apple Podcasts, Google, Spotify, or wherever you get your podcasts. Don't forget to check out our blog, [consumerfinanceobserver.com](http://consumerfinanceobserver.com). If you check out our blog, you'll already find on there a blog that we've written about the guidance that Kaitlin discussed in detail today.

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