Testimony of
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Digital Currency and Blockchain Technology

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Introduction

Chairman Burgess, Ranking Member Schakowsky and members of the Committee, my name is John Beccia, and I am the General Counsel and Chief Compliance Officer of Circle Internet Financial, a consumer Internet company focused on transforming the world economy with secure, simple, and less costly technology for storing and using money. Circle is a member of the Electronic Transactions Association (ETA), the leading trade association for the payments industry, representing 500 companies worldwide who offer electronic transaction processing products and services.

I am grateful to be part of the Subcommittee's disrupter series and appreciate your efforts to examine the blockchain and its numerous applications. When it comes to technology like the blockchain, I believe this a pivotal moment that could lead to significant developments for several areas of commerce. The blockchain represents one of the most important technical and economic innovations of our time that could benefit businesses and individuals around the globe.

So what is the blockchain, exactly? The blockchain is a decentralized ledger of transactions that can be used to secure and validate any exchange of data, including assets, such as commodities or currencies. It offers multiple possibilities as it can be applied to any type of business transaction. It has the potential to impact myriad industries, such as real estate, media, hospitality, retail, life sciences, healthcare, government, and energy. As a result of the numerous applications, the world's largest companies have established working groups and dedicated significant resources to investigate how it can be used. Today, I will be focusing my comments on how the blockchain can impact financial services through digital currency.

The Blockchain's Impact on Financial Markets

There's no question that the existing payment system can be improved. In 2013, the Federal Reserve issued a report outlining payment trends and deficiencies and later created task forces to examine how to improve the speed, safety and efficiency of the U.S. payment system.[1] The traditional payment system is a hub and spoke model in which a single institution, such as a bank, acts as the hub and disseminates information. The movement of value is controlled by closed networks that charge fees for transactions and have a cumbersome process that is subject to data breaches and privacy leaks.

Luckily, we have seen a dramatic shift in financial services over the last several years with the development of new payment products, many of which were created by ETA members. Today, there are better choices to send and receive convenient, cost effective and timely payments, such as mobile applications, prepaid cards and P2P networks. Digital currency and the blockchain hold promise to further improve payments by lowering costs for businesses, decreasing fraud risk for consumers and merchants, increasing consumer privacy and protection, and expanding the market for financial products on a worldwide basis. With digital currency, there is no central authority or gatekeeper. Instead, account value is stored across the distributed network of computers. Like other open protocols that power the global Internet, the blockchain would make the exchange of value ubiquitous and free - the same way that people can now share information over the Internet today.

Benefits of Digital Currency

Digital currency has the ability to transform, both everyday payments and the wider economic outlook. For consumers, it can be used for a wide variety of transactions, such as co-workers splitting a lunch tab, a mom sending her freshman daughter grocery money, friends chipping in for a shower gift or businessman sending money to a relative overseas. In terms of benefits, digital currency makes these transactions simple and offers lower fees and instant access to funds in multiple currencies. It offers privacy and security as transactions on the blockchain do not involve dissemination of personal financial information that is later subject to identity theft or data breaches. While some question the anonymity component of the blockchain, it actually offers a real opportunity

[1] The 2013 Federal Reserve Payments Study Recent and Long-Term Payment Trends in the United States: 2003 – 2012 Summary Report and Initial Data Release Research Sponsored by the Federal Reserve System, December 19, 2013 and Strategies for Improving the U.S. Payment System, Federal Reserve System, January 26, 2015 (fedpaymentsimprovement.org)

to create new identity management tools that could benefit consumers. Digital currency has the ability to reach underserved and unbanked communities and radically expand access to financial services on a worldwide basis. Not only are these transactions instant and secure, they are offered at a fraction of the costs of remittance fees, which average 7.7% worldwide for cross-border payments.[2]

Merchants enjoy several attractive benefits as digital currency transactions are not subject to interchange fees, chargeback risks and the liability of storing personal customer information. This is especially beneficial to small business owners who may shun certain forms of payment due to high fees and risks associated with these transactions.

Blockchain technology is still in its infancy. While there are over 12 million people with digital wallets, more than 100,000 merchants accepting Bitcoin and nearly 200,000 daily Bitcoin transactions, the majority of consumers are still learning about the benefits and some have questions about the risks.[3] The users are early adopters, those seeking financial privacy and those who see Bitcoin as an asset rather than a currency. Like other technologies and innovations built on the Internet, adoption will take time as the technology improves, regulatory and policy issues are addressed and users become comfortable with the products and services. However, it is clear that a strong infrastructure has been created and digital currency will have staying power as it addresses needs among multiple demographics. For example, millennials seek a different way to send, store and receive money. In fact, 33% of millennials in the U.S. do not have a desire to interface with traditional banks and 70% feel that the payments system will be vastly different in five years[4]. As consumers' behaviors change, so must the technology and businesses that provide these services.

The Role of Start-ups in Payments Innovation

Venture capitalists have invested almost $1 billion in early stage companies that seek to promote the benefits of digital currency. These businesses include exchanges, wallet providers, payment processors and other financial vehicles.

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[2] IMF Staff Discussion Note: Virtual Currencies and Beyond Initial Considerations, Dong He, Karl Habermeier, Ross Leckow,Vikram Haksar, Yasmin Almeida, Mikari Kashima,Nadim Kyriakos-Saad, Hiroko Oura,Tahsin Saadi Sedik, Natalia Stetsenko, and Concepcion Verdugo-Yepes, January 2016

[3] Coindesk, State of Bitcoin and the Blockchain, January 28, 2016

[4] See www.millenialdisruptionindex.com, Scratch Viacom Media Networks

Circle is one of the companies trying to alter the payments landscape. We believe money should be exchanged the same way people exchange messages, photos, content and other information over the Internet. Circle enables people to send money to anyone anywhere anytime with simplicity, speed, security, and no fees. Circle offers a social payments app that allows users to make payments in local currency, P2P payments across currencies that are on the Circle platform and payments to anyone anywhere in the world using the blockchain. This is done in fun mobile application experience that integrates social media and other messaging tools like GIFs, photos and emojis. Unlike other closed systems and networks, because companies like Circle utilize the blockchain for payments to individuals and merchants, customers have the ability to send payments freely to anyone across the globe.

It is not just start-ups and venture capitalists interested in this technology. A group of 42 of the world's largest banks formed a group called R3 CEV, which is actively testing the blockchain and its applications to legacy systems and the existing financial structure. They have several pilot programs in development and recently announced a trial testing for the trading of fixed income assets on the blockchain.[5] Members of the ETA are similarly, looking at ways to tap into this technology and apply it to their business.

Incubation among both smaller firms and global banks is setting the stage for the expansion of financial products, future economic growth and job development as burgeoning industries emerge. Jobs are being created for engineers, data scientists, compliance and risk professionals, finance staff and marketing personnel who are becoming experts in a new field. There is also a substantial infrastructure being built through vendors and professional services that are supporting this industry.

Risks and Innovations in Risk Management

The risks of digital currency have been well documented. The European Banking Agency (EBA) July 2014 report outlines over 70 risks associated with digital currency ranging from risks to users, risks to non-user market participants, risks to financial integrity, risks to existing payment systems, and risks to regulatory authorities.[6] To date, the majority of the policy discussions have involved four key areas: financial crimes risks, consumer protection, security and taxation. While these risks can't be ignored, the benefits of digital currency outweigh the potential downside and each of one of the risks can be properly mitigated with effective regulatory regimes and industry best practices.

[5] See R3cev.com press release dated March 3, 2016
[6] European Banking Authority Opinion on 'Virtual Currencies', July 4, 2014

Financial Crimes

Like other financial products, digital currency is subject to money laundering and related risks. The most notable case is Silk Road, which was a dark web site where bitcoin was used to purchase illegal goods and services before being shut down by the FBI. As regulated entities, companies like Circle are required to maintain an anti-money laundering compliance program that includes Know Your Customer (KYC) procedures, transaction monitoring of client activity and regulatory reporting of suspicious activity. We partner closely with U.S. and international law enforcement to investigate illegal use of digital currency and participate in working groups such as the Bank Secrecy Act Advisory Group (BSAAG), Blockchain Alliance and Europol's European Cybercrime Centre (EC3).

Unfortunately, portions of the Bank Secrecy Act and global anti-money laundering laws are outdated and should be revisited and revised to account for 21st century technology. If the goal is to "follow the money" and catch bad actors, we need to move beyond collecting data on individuals or filing reports and keeping records based on arbitrary currency amounts. The transparent nature of the blockchain offers the ability to detect illicit activity. We have developed risk management protocols and use forensic tools that provide insight into transactions on the blockchain. As a result, we collect more robust data that can be shared with law enforcement. Risk engines created by digital currency companies like ours could be a model for regulators, law enforcement and other traditional financial services firms.

Consumer protection

With the emergence of any nascent industry, especially those that handle customer funds, consumer education and protection should be at the forefront. Consumers will want to understand these products and know that the transactions are secure. The Consumer Financial Protection Bureau (CFPB) and the Federal Trade Commission (FTC) have issued consumer advisories warning about fees, price volatility, and issues relating to merchant transactions with digital currencies.[7] Both agencies have been collecting complaints from consumers who are using digital currency. We expect that the agencies may require further disclosures around these products in the future. In the meantime, companies should have detailed user agreements and transaction details that provide clear and conspicuous language about fees, risks, consumer obligations

[7] CFPB Bulletin, Risks to consumers posed by virtual currencies, August 2014 and FTC Consumer Information Blog Posted title, Before Paying with Bitcoins Kristin Cohen, June 22, 2015.

and dispute resolution procedures. Consumers need to need to know their funds are secure, which is one reason our customers holding U.S. dollars in their accounts have FDIC protection. We have also secured private insurance to protect against theft of digital assets for 100% our customers' funds.

Security

Digital currency price fluctuations can be volatile and digital assets must be secured properly to avoid theft. We saw this play out with the infamous loss of 750,000 Bitcoin at a Japanese digital currency exchange called Mt. Gox. These risks underscore the need to ensure digital assets are free from cybersecurity attacks, social engineering and other potential scams that could cause customers to lose funds. Industry members that act as custodians for digital assets need to take that responsibility seriously. The industry has responded by creating best in class protocols to secure online and offline digital assets, which offer multiple layers of protection and redundancies. We support the White House's recently announced Cybersecurity Action Plan[8] and believe that as digital currency matures, companies in this space need to develop ways to ensure financial transactions are secure and work closely with traditional and emerging payment companies in an effort to accomplish this same goal.

Taxation

Most countries, including the U.S., have determined that digital currency is property (or an asset) rather than currency and require reporting of gains and losses of these transactions.[9] Today's reporting and recordkeeping requirements are somewhat difficult and may negatively impact everyday usage. Also, because digital currency transactions are anonymous and involve the movement of high value across borders this creates potential tax evasion risks and reporting difficulties for business and consumers. While there are complexities for end users, the blockchain could transform financial audits and accounting by providing for more reliable, transparent and real-time financial reviews.

All of the risks discussed here are real, but not insurmountable. These risks are not creating barriers, but should instead be a catalyst for positive changes to legacy risk management techniques and archaic laws and regulations.

Payment Regulation - Past, Present and Future

[8] https://www.whitehouse.gov/the-press-office/2016/02/09/fact-sheet-cybersecurity-national-action-plan.
[9] See https://www.irs.gov/uac/Newsroom/IRS-Virtual-Currency-Guidance.

The regulatory environment for digital currency has changed dramatically over the last couple of years. It has moved from a position of fear and uncertainty to an embracing of the possibilities. The advent of digital currency has created unprecedented coordination with regulatory agencies, law enforcement and industry in an effort to further understand the benefits and risks of this technology.

Circle has been thoroughly engaged on regulatory issues since the company began operations. We want to educate governments and be transparent as we enter new markets and seek regulatory approvals. We have coordinated and testified before key state and federal government agencies in the U.S. and abroad and believe that a certain level of regulation is needed to promote stability and consumer confidence. Regulations should focus on activities that pose the highest risk and should be measured and allow innovation to develop.

Development of the Current Regulatory Environment

The pivotal marker for regulation came in March 2013, when the Financial Crimes Enforcement Network (FinCEN) issued guidance that firms which exchange digital currency for fiat currency must register as a money service business (MSB) and implement a formal anti-money laundering program.[10] On the state level, similar companies need to be licensed as money transmitter on a state-by-state basis. This is a more onerous process since states have different requirements and most current state statutes do not account for digital currency. While some larger states like California have pending legislation to deal with digital currency specifically[11], the New York Department of Financial Services (NYDFS) issued the first ever BitLicense in 2015.[12] The BitLicense offers similar consumer protections as money transmission laws, but also takes into account risks and reporting considerations specific to digital currency. Circle is the first (and currently only) company to receive a BitLicense. In addition to the BitLicense, the Conference of State Bank Supervisors (CSBS) has issued principles for a regulatory framework in attempt to provide consistency and clarity among the states and combat the current unwieldy licenses and oversight process for money transmitters.[13]

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[10] US Department of the Treasury, Financial Crimes and Enforcement Network, "Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies" (Guidance FIN-2013- G001, March 18, 2013).

[11] See https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201520160AB1326.

[12] See NYDFS Regulations on Virutal Currencies at http://www.dfs.ny.gov/legal/regulations/adoptions/dfsp200t.pdf.

[13] Conference of State Bank Supervisors, State Regulatory Requirements for Vitrtual Currency Activities CSBS Model Regulatory Framework 10, (Sep. 2015).

From a global perspective, European jurisdictions had been slow to adopt digital currency regulations following the EBA report, however recently the UK Treasury has announced they are working on new guidance and UK regulators are accepting e-money applications for digital currency firms[14]. The EU Commission has focused on issuing new guidance to address the money laundering risks as part of the Fourth Money Laundering Directive. In addition, Japanese and Canadian regulators have issued positive statements regarding new regulations that will not interfere with the development of this technology. And, central banks in England and China have voiced a desire to issue government backed digital currency and review how the blockchain could impact monetary policy in the long-term.

Future Regulatory Innovation

While we are encouraged by the regulatory framework that has developed to date, there is still work to be done. Some jurisdictions are still skeptical of digital currency and have varying degrees of guidance. Regulatory uncertainty makes it difficult for businesses to operate and consumers to have confidence in the system. In addition, we need consistent regulations. Any level of regulatory arbitrage, whether between U.S. states or from an international perspective will increase risks and not allow the technology to flourish. We would like to see continued innovation in the regulatory space. The convergence of new Internet-based methods of savings and lending, new digital currency-based payment services, and potential government-issued digital currency should lead to the development of new forms of "Internet Bank Charters" that define the rules and requirements of operating a global digital bank that uses fundamentally new methods of intermediating financial risk. We are encouraged that federal financial regulators, like the Office of the Comptroller of the Currency (OCC), have created a working group to "develop a framework to evaluate new and innovative financial products and services".[15] We encourage Congress to consider more efficient charter choices and regulations for these industries.

Conclusion

The Comptroller of the Currency, Thomas Curry, stated it best when he noted that "new payment systems are creating greater efficiencies and convenience, and virtual

[14] See HM Treasury report titled, Banking for the 21st Century: Driving Competition and Choice, March 2015.
[15] Thomas J. Curry Comptroller of the Currency Before the Federal Home Loan Bank of Chicago Chicago, Illinois August 7, 2015.

currencies offer the prospect of instantaneous transactions directly between individuals and entities on a global basis". He further stated that "these innovations are potentially revolutionary in their impact, and are advancing at a breakneck speed."[16] Digital currency offers the ability move money freely at low cost in safe and secure manner to a variety of users. This type of innovation should be encouraged and embraced. While there are risks associated with digital currency, these risks can be addressed by the industry and regulators. Governments should resist the temptation to overreact to risks or external events. We believe a bold and balanced approach toward oversight on behalf of lawmakers is paramount to success of digital currency.

Disruption in payments is happening right now. The lessons learned from digital currency's use of the blockchain will ultimately help shape exciting advancements for other industries. Innovations like smart contracts that are self-executing and able to verify when certain conditions are met, or a blockchain-based property ownership recordkeeping system that can reduce costs and fraud in the real estate market are just some examples of what the future holds.

Mr. Chairman, that concludes my prepared testimony. On behalf of Circle and the the ETA, I appreciate the opportunity to appear before you. I would be happy to answer any questions for the Committee.

[16] Remarks by Thomas J. Curry Comptroller of the Currency Before the Institute of International Bankers Washington, D.C., March 2, 2015.