

Response to Request for Information
by Charles G. Cooper
Commissioner
Texas Department of Banking
House Committee on Pensions, Investments, and Financial Services
August 25, 2022

Members of the Pensions, Investments, and Financial Services Committee, thank you for the opportunity to submit a response regarding the regulatory treatment of virtual currency at the state and federal level.

Texas Department of Banking (Department) Overview

The Department was established in 1905 by the 29th Legislature. Our mission is to ensure Texas has a safe, sound, and competitive financial services system. The 81st Texas Legislature amended the Texas Finance Code and granted Self-Directed, Semi-Independent status to the Department. Further, the 86th Legislature passed Senate Bill 614 and House Bill 1442 extending the existence of the Department through September 1, 2031, under the continued oversight of the Finance Commission.

The Department supervises State-Chartered Commercial Banks, Foreign Bank Organizations, Public Trust Companies, Exempt Trust Companies, Money Services Businesses (MSB), Prepaid Funeral Contract Sellers (PFC), Perpetual Care Cemeteries (PCC), and Check Verification Entities. The chart below illustrates the entities by type and total assets.

Regulated Entities	Number of Entities As of June 30, 2022	Total Assets \$ (millions)
Commercial Banks	213	\$419,289
Foreign Bank Agencies	23	\$119,970
Trust Companies	35	\$150,098
Prepaid Funeral Licensees	342	\$4,542
Perpetual Care Cemeteries	243	\$421
Money Service Businesses	198	\$218,813
Check Verification Companies	2	NA
Total	1,056	\$913,133

Regulatory Framework as it Relates to Virtual Currency

The advent of digital assets such as virtual currencies, and their subsequent proliferation in recent years, has raised novel questions for regulators as to how to treat them under existing regulatory regimes. Among the Department's regulated industries, MSBs make up the bulwark of activity involving virtual currency; however, the Department has seen an increase in activity associated with state banks and trust companies.

Regulatory Treatment of Virtual Currencies by the Department

STATE BANKS AND TRUST COMPANIES

In 2021, the Department issued Industry Notice 2021-03 (Notice), affirming that Texas state-chartered banks may provide customers with virtual currency custody services, so long as adequate protocols are in place to effectively manage associated risks and comply with applicable law. (Exhibit A) In issuing the Industry Notice, the Department confirmed that Texas banks have the authority to provide these safekeeping services pursuant to Texas Finance Code § 32.001. The Notice further confirmed that banks may offer these services themselves, or via partnerships with third-party entities. The Department has subsequently confirmed that the Notice is applicable to state-chartered trust companies as well. As a result of the notice, the Department fielded a significant number of inquiries from the industry and expects these services to continue to gain in popularity going forward.

MSBs

Under Chapter 151 of the Texas Finance Code (Finance Code), MSBs engaged in the business of money transmission must obtain a license to do so in this state unless they are otherwise exempt or appointed as an authorized delegate of a licensee. Money transmission is defined in Finance Code § 151.302(a)(4) as "the receipt of money or monetary value by any means in exchange for a promise to make the money or monetary value available at a later time or different location." The terms "money" and "monetary value" are defined in section 151.302(a)(3) as "currency or a claim that can be converted into currency through a financial institution, electronic payments network, or other formal or informal payment system." Finance Code §151.501(b)(1) defines currency as "the coin and paper money of the United States or any country that is designated as legal tender and circulates and is customarily used and accepted as a medium of exchange in the country of issuance."

As noted in the guidance described below, the Department has determined that most virtual currencies do not fall within these definitions. Nevertheless, as it relates to virtual currency, a broad range of business activity may require a license, such as operating a virtual currency exchange platform, conducting trades involving the exchange of fiat currency and certain stablecoins, issuing stablecoins, or providing virtual currency custodial services.

In 2014, in response to the growing popularity of virtual currencies, particularly cryptocurrencies like Bitcoin and its progeny, the Department issued Supervisory Memorandum 1037 (Memorandum) on the Regulatory Treatment of Virtual Currencies Under the Texas Money Services Act. (Exhibit B) Texas was the first state to publish such guidance and the Memorandum served as a template for guidance published in other states. The Memorandum covers a variety of activity involving virtual currencies and offers guidance on the licensing implications under Chapter 151. With this guidance, the Department concluded that certain virtual currencies, such as Bitcoin, do not fit the statutory definitions of either currency, money, or monetary value, and consequently do not by themselves trigger the licensing requirements. However,

some common business activities that involve the receipt of government issued currency can obligate an entity to obtain a money transmission license.

In response to the widespread introduction of stablecoins in the virtual currency industry, the Department in 2019 revised the Memorandum to make clear that certain stablecoins, backed by the issuing entity with sovereign currency, are considered “monetary value” under the Texas Finance Code. Accordingly, money transmission activity involving these types of stablecoins triggers the licensing requirements of Chapter 151. The revision also included additional information regarding a cybersecurity audit required of licensees that engage in activity involving virtual currencies.

87th Legislature (HB 4474)

During the 87th Legislative Session, the Texas Legislature enacted HB 4474, relating to the control of virtual currency and the rights of purchasers who obtain control of virtual currency for purposes of the Uniform Commercial Code. The Bill amended the Texas Business & Commerce Code to include a definition of virtual currency, describe how a security interest in a virtual currency is perfected, and provide a framework as to how control of a virtual currency is established. The amendments provide Texas banks with clarification and certainty regarding the legal status of virtual currencies in this state.

Regulatory Treatment of Virtual Currency in Other States

Specific treatment of activity involving virtual currencies varies state-by-state. Many state regulators have taken a similar approach as the Department and regulate virtual currency under existing money transmission laws and regulations. A majority of these states have enacted legislation to expressly incorporate virtual currency into their money transmission statutes, while others have simply published guidance indicating that certain activity involving virtual currencies may trigger money transmission licensing obligations. Some states, including New York, Louisiana, and Wyoming, have adopted complex virtual currency-oriented regulatory regimes separate from their money transmission regulation.

The “BitLicense” is a regulatory framework originally introduced by the New York Department of Financial Services (NYDFS) in 2014. The BitLicense operates in a similar fashion to money transmission regulatory framework and is applicable to virtual currency business activity performed by entities whose business operations are in New York and/or are conducted with New York residents. The NYDFS has also chartered a number of limited purpose trust companies (LPTC) authorized by the Superintendent to engage in virtual currency business activity. A key distinction between the two is that an LPTC can exercise fiduciary power while a holder of a BitLicense cannot. LPTCs are generally required to obtain a Texas money transmission license if they seek to engage in licensable activity in this state as there is no applicable exemption for these entities under Chapter 151.

Like the New York BitLicense, Louisiana adopted the Virtual Currency Business Act in 2020, which requires virtual currency businesses to obtain a separate license to conduct business in the state. The licensing scheme is similar to the money transmission regulatory framework, including prudential standards and ongoing supervision by the Louisiana Office of Financial Institutions.

The Wyoming Division of Banking authorized the Special Purpose Depository Institution (SPDI) charter in 2019. The SPDI charter was introduced as part of a broad spectrum of digital asset-related statutes and regulations adopted in Wyoming in the last few years. SPDIs are authorized to receive deposits and conduct other activity incidental to the business of banking in Wyoming. The entities are not insured by the Federal Deposit Insurance Corporation and their legal status in other states is unresolved; in Texas,

(e.g., a SPDI) would be required to obtain a money transmission license for any licensable activity as they do not qualify for the financial institution exemption due to the lack of federal insurance. SPDIs have also run into a roadblock from the Federal Reserve in that they have not been permitted to have a Fed master account.

Money Transmission Modernization Act

On September 9, 2021, the Conference of State Bank Supervisors (CSBS) published the Money Transmission Modernization Act (MTMA) as part of its ongoing effort to streamline licensing, supervision, and examinations for money transmitters operating in various states. The MTMA is a collaborative effort drafted by a working group consisting of both state regulators and industry experts. The primary goals of the MTMA are to establish a common baseline of regulatory standards to be used across the country, making it easier for companies to operate across state lines; enable efficient cooperation among states to work together in licensing and supervision of money transmitters; and strengthen consumer protection through enhanced prudential standards and disclosure requirements.

As it relates to virtual currency, the MTMA provides multiple avenues through which activity involving virtual currency may be regulated. For those states that prefer a stand-alone portion of the law, the MTMA includes an optional module that provides a regulatory framework specific to virtual currency businesses. Alternatively, the MTMA includes a very broad definition of “monetary value” that unequivocally includes virtual currency. Finally, states may choose to do what many have done with the current statutes and expressly incorporate virtual currency to remove all doubt.

To date, several states have introduced and enacted legislation relating to the MTMA. While many of these states are going through a piecemeal process by adopting portions of the act at a time, the MTMA was enacted in full in Arizona and introduced in full in Alaska. None of these states have chosen to adopt the virtual currency module.

Regulatory Treatment of Virtual Currency at the Federal Level

At the Federal level, regulation of virtual currencies is varied and uncertain. Both the Securities Exchange Commission (SEC) and the Commodities Futures Trading Commission (CFTC) have published guidance and initiated enforcement actions against entities engaged in activity involving virtual currency. In November 2021, the three banking regulators, the Board of Governors of the Federal Reserve System (Federal Reserve), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC), issued a joint statement as part of an interagency effort confirming that additional clarity on whether certain virtual currency-related activity by banks is warranted, including what activity is legally permissible and the expectations of the regulators as to safety and soundness, consumer protection, and compliance with existing laws and regulations.

The three regulators have also each issued guidance requiring their regulated entities to notify them prior to engaging in activity relating to virtual currencies. For the OCC, this was a claw back of prior guidance issued under former Acting Comptroller Brian Brooks which confirmed that national banks have the authority to provide a number of services related to virtual currency. The clarified guidance issued under Acting Comptroller Michael Hsu requires banks under the OCC’s supervision to seek and receive approval before doing so.

The Financial Stability Oversight Council (FSOC) was established by the Dodd-Frank Wall Street Reform and Consumer Protection Act following the 2008 financial crisis. FSOC is an advisory body whose role is to

make policy recommendations to member agencies and Congress. FSOC is composed of fifteen members, including the heads of the federal financial agencies and state regulators in the banking, securities, and insurance industries. I am currently serving my second term as a state banking regulator member. FSOC's 2021 Annual Report identified potential benefits offered to consumers and providers of financial services through financial innovation involving digital assets but also cautioned that innovation can create new risks. The report recommended that state and federal regulators continue to examine these potential risks to the financial system posed by virtual currencies and encouraged coordination among the regulators to address them.

The President's Working Group on Financial Markets (PWG) is an advisory group consisting of the Secretary of the Treasury, and the Chairperson of each of the Federal Reserve, the SEC, and the CFTC. In November 2021, along with the FDIC and the OCC, the PWG released a report on stablecoins recommending Congress take significant legislative measures to curb prudential risks that could result in harm to consumers and the U.S. financial system. The report's recommendations include legislation requiring a stablecoin issuer to be an insured depository institution and custodial wallet providers be subject to appropriate *federal oversight*.

On March 9, 2022, President Biden issued Executive Order No. 14067 on Ensuring Responsible Development of Digital Assets (Order). The Order is a general policy statement that instructs federal actors to evaluate and take various actions focused on key areas including: (1) consumer and investor protection; (2) financial stability; (3) illicit activity; (4) U.S. competitiveness on a global stage; (5) financial inclusion; and (6) responsible innovation.

Around fifty bills covering a wide range of topics related to virtual currency have been filed in the 117th U.S. Congress. Perhaps most notably is a bipartisan bill filed in June 2022, the "Responsible Financial Innovation Act," sponsored by Senators Lummis and Gillibrand. The bill purports to establish a comprehensive regulatory framework applicable to digital assets that would clarify the jurisdiction of certain federal regulatory agencies, taxation, and establish additional consumer protections.

The Department is committed to ensuring a safe, sound, and competitive financial system in Texas. While the widespread introduction of virtual currency brings with it certain unique regulatory challenges, the Department has met those challenges head-on and looks forward to continuing to do so in the future.

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Exhibit A



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INDUSTRY NOTICE 2021-03

Date: June 10, 2021

Authority of Texas State-Chartered Banks to Provide Virtual Currency Custody Services to Customers

This notice affirms that Texas state-chartered banks may provide customers with virtual currency custody services, so long as the bank has adequate protocols in place to effectively manage the risks and comply with applicable law.

Texas state-chartered banks have long provided their customers with safekeeping and custody services for a variety of assets. These services play a crucial role in the business of banking as customers look to banks to offer secure and dependable storage. While custody and safekeeping of virtual currencies will necessarily differ from that associated with more traditional assets, the Texas Department of Banking believes that the authority to provide these services with respect to virtual currencies already exists pursuant to Texas Finance Code § 32.001.

Virtual currency is an electronic representation of value intended to be used as a medium of exchange, unit of account, or store of value. Virtual currencies do not exist in a physical form. Instead, they are intangible and exist only on the blockchain or distributed ledger associated with that virtual currency. The owner of the virtual currency holds cryptographic keys associated with the specific unit of virtual currency in a digital wallet. The keys enable the rightful owner of the virtual currency to access and utilize it further.

What virtual currency custody services a bank chooses to offer will depend on the bank's expertise, risk appetite, and business model. For instance, the bank may choose to allow the customer to retain direct control over their own virtual currency and merely store copies of the customer's private keys associated with that virtual currency. Alternatively, the bank may cause the customer to transfer their virtual currency directly to the control of the bank, creating new private keys that are then held by the bank on behalf of the customer. As with the method of custody services, several secure storage options are available to the bank, each of which has distinctive characteristics pertaining to level of security and accessibility. The bank will have to determine which storage option best fits the circumstances.

The Department has previously determined that custody services may be provided by a Texas state-chartered bank in either a fiduciary or non-fiduciary capacity. In providing such services in a non-fiduciary capacity, the bank acts as a bailee, taking possession of the customer's asset for safekeeping while legal title to that asset remains with the customer. The extent of the bank's duties regarding the asset depends on the custodial agreement between bank and customer but generally,

the bank owes its customer the duty to use proper care to keep the asset safely and to return it unharmed upon request.

A bank proposing to offer custody services in a fiduciary capacity must possess trust powers, which may require a charter amendment and/or compliance with 7 Texas Administrative Code § 3.23 prior to doing so. In its fiduciary capacity, the bank has the authority to manage virtual currency assets as it would any other type of asset held in such capacity.

Prior to a bank entering a new line of business, such as offering virtual currency services, it is incumbent on management to conduct due diligence and carefully examine the risks involved in offering a new product or service through a methodical risk assessment process. Should management and the board of directors decide to move forward, effective risk management systems and controls must be implemented to measure, monitor, and control relevant risks associated with custody of digital assets.

Necessary controls consist of administrative controls, such as policies and procedures; technical controls, such as access controls and authentication; and physical controls, such as protection of hardware and data specific to the virtual currency held. The bank should also confirm the existence of adequate coverage with its insurance carrier.

Due to the technical nature of holding virtual currency, the bank may choose to establish a relationship with a service provider with expertise in handling virtual currency. Therefore, it is incumbent on the bank to maintain a strong service provider oversight program that addresses risk in the service provider relationship from the first steps of due diligence through a potential termination of the service provider relationship. More information on outsourcing technology services can be found in the Federal Financial Institutions Examination Council's [*IT Examination Handbook for Outsourcing Technology Services*](#).

If you have any questions regarding the provision of virtual currency custody services, please contact Marcus Adams, Assistant General Counsel, via [email](#) or by phone at (512) 475-1236.



TEXAS DEPARTMENT OF BANKING

★ *Dedicated to Excellence in Texas Banking* ★

SUPERVISORY MEMORANDUM – 1037

April 1, 2019 (rev.)

TO: All Virtual Currency Companies Operating or Desiring to Operate in Texas

FROM: Charles G. Cooper, Banking Commissioner

SUBJECT: Regulatory Treatment of Virtual Currencies Under the Texas Money Services Act¹

PURPOSE

Virtual currencies have proliferated in recent years and, particularly with the advent of cryptocurrencies like Bitcoin, have raised novel questions in relation to money transmission and currency exchange. This supervisory memorandum outlines the policy of the Texas Department of Banking (Department) with regard to virtual currencies. This policy expresses the Department's interpretation of the Texas Money Services Act,² and the application of its interpretation to various activities involving virtual currencies. While the popularity of Bitcoin has sparked new discourse on the nature of money and transferability of value, this memorandum seeks only to establish the regulatory treatment of virtual currencies under existing statutory definitions.

TYPES OF VIRTUAL CURRENCY

In broad terms, a virtual currency is an electronic medium of exchange typically used to purchase goods and services from certain merchants or to exchange for other currencies, either virtual or sovereign.³ As of the date of this memorandum the Department is not aware of any virtual currency that has legal tender status in any jurisdiction, nor of any virtual currency issued by a governmental central bank. As such, virtual currencies exist outside established financial institution systems. There are many different virtual currency schemes, and it is not easy to classify all of them, but

¹ This memorandum revises and supersedes the policy issued on January 2, 2019 which addressed current trends in the Virtual Currency field, including the widespread introduction of stablecoins to the market. Current revisions to this memorandum are non-substantive.

² Texas Finance Code Chapter 151.

³ In this memorandum the term sovereign currency will be used to mean government-issued currencies with legal tender status in the country of issuance. In most of the literature pertaining to virtual currency, the term fiat currency is used to refer to government-issued legal tender. Technically, fiat currency is a subset of government-issued legal tender. Fiat currency has no intrinsic value; its value is established by law. By contrast, commodity-backed currency has intrinsic value insofar as it represents a claim on a commodity such as gold or silver. Here, sovereign currency means both commodity-backed and fiat currency issued by a government and designated as legal tender.

for purposes of this memorandum, they can generally be divided into two basic types: centralized and decentralized.

Centralized Virtual Currency

Centralized virtual currencies are created and issued by a specified source. They rely on an entity with some form of authority or control over the currency. Typically, the authority behind a centralized virtual currency is also the creator. Centralized virtual currencies can be further divided into subclassifications that in some cases, become too complex to apply a universal policy. Some can be purchased with sovereign currency but cannot be exchanged back to sovereign currency; some can be converted back to sovereign currency; some are used only for purchase of goods and services from a closed universe of merchants, while others may have a theoretically open universe of merchants.

One particular subclass of centralized virtual currencies is stablecoin. Stablecoins are a form of centralized virtual currencies that is backed by the issuer with sovereign currency, precious metals, or cryptocurrency and therefore hold intrinsic value. By pegging these coins to an underlying asset, the intent is to create a less volatile virtual currency that retains a stable value. The most popular form of stablecoins is backed by a sovereign currency of which the issuer keeps a reserve in an amount equal to or greater than the amount of issued stablecoin. As it pertains to money transmission regulation, an important aspect of these sovereign-backed stablecoins is the “redemption right” allowing the stablecoin holder to redeem the coin for sovereign currency from the issuer. This redemption right may be explicitly granted to a stablecoin holder through a user agreement with the issuer or it may be an inherent right granted to the coin holder by the issuer guaranteeing it will buy back coins to keep the value stable. The most popular sovereign-backed stablecoin at the time of this writing is Tether, a coin backed 1-to-1 by U.S. Dollars so one Tether coin is the equivalent value of one USD at all times.

Decentralized Virtual Currency

Decentralized virtual currencies are not created or issued by a particular person or entity, have no administrator, and have no central repository. Thus far, decentralized currencies are all cryptocurrencies. A cryptocurrency is based on a cryptographic protocol that manages the creation of new units of the currency through a peer-to-peer network. The creation of cryptocurrency happens through a process called mining that basically involves running an application on a computer that performs proof-of-work calculations. When the computer performs a sufficient amount of these calculations, the cryptocurrency's underlying protocol essentially generates a new unit of the currency that can be delivered to the miner's wallet. Because users' wallets act as the connection points of the cryptocurrency's peer-to-peer network, transfers of cryptocurrency are made directly from wallet to wallet, without any intermediary, whereas digital transfers of sovereign currencies must be made through one or more intermediaries such as a financial institution or money transmitter.

One important characteristic of cryptocurrency is its lack of intrinsic value. A unit of cryptocurrency does not represent a claim on a commodity and is not convertible by law. And unlike fiat currencies, there is no governmental authority or central bank establishing its value through law or regulation. Its value is only what a buyer is willing to pay for it. Most cryptocurrencies are traded on third party exchange sites, where the exchange rates with sovereign

currencies are determined by averaging the transactions that occur. Some experts consider cryptocurrency to be a new asset class that is neither currency nor commodity, but possessing characteristics of both, as well as characteristics of neither.

ANALYSIS

Currency Exchange

Exchanging virtual currency for sovereign currency is not currency exchange under the Texas Finance Code. Finance Code § 151.501(b)(1) defines currency for purposes of currency exchange as "the coin and paper money of the United States or any country that is designated as legal tender and circulates and is customarily used and accepted as a medium of exchange in the country of issuance." Because neither centralized virtual currencies nor cryptocurrencies are coin and paper money issued by the government of a country, they cannot be considered currencies under the statute. Therefore, absent a legislative change to the statute, no currency exchange license is required in Texas to conduct any type of transaction exchanging virtual with sovereign currencies.

Money Transmission

In many instances, factors distinguishing the various centralized virtual currencies are complicated and nuanced, and to make money transmission licensing determinations the Department must individually analyze centralized virtual currency schemes. Accordingly, this memorandum does not offer generalized guidance on the treatment of centralized virtual currencies, other than sovereign-backed stablecoins, by the Money Services Act's money transmission provisions.

Money transmission licensing determinations regarding transactions with cryptocurrency and sovereign-backed stablecoins turn on the single question of whether either should be considered "money or monetary value" under the Money Services Act. Under Finance Code §151.301, money transmission is "the receipt of money or monetary value by any means in exchange for a promise to make the money or monetary value available at a later time or different location." Although there is a great amount of discussion over whether cryptocurrencies should be considered money, for purposes of money transmission regulation in Texas the term is defined by statute. Finance Code § 151.301(b)(3) provides that "'money' or 'monetary value' means currency or a claim that can be converted into currency through a financial institution, electronic payments network, or other formal or informal payment system." As already stated, a cryptocurrency is not currency as that word is defined in the Money Services Act. A unit of cryptocurrency is also not a claim.⁴ It does not entitle its owner to anything and creates no duties or obligations in a person who gives, sells, or transfers it. There is no entity that must honor the value of a cryptocurrency or exchange any given unit of a cryptocurrency for sovereign currency. For comparison, under federal law U.S. coin and paper currency must be honored for payment of all debts, public charges, taxes, and dues, and the U.S. Treasury Department must redeem it for "lawful money."⁵ But the owner of a unit of a cryptocurrency has no right or guaranteed ability to convert that unit to sovereign currency. The

⁴ The legal definition of a claim can essentially be stated as a right enforceable by a court. *See* Black's Law Dictionary 264 (8th ed. 2004).

⁵ 31 U.S.C. §5103; 12 U.S.C. §411 ("The said notes shall be obligations of the United States and shall be receivable by all national and member banks and Federal Reserve banks and for all taxes, customs, and other public dues. They shall be redeemed in lawful money on demand at the Treasury Department of the United States, in the city of Washington, District of Columbia, or at any Federal Reserve bank.").

only way to convert a unit of cryptocurrency to sovereign currency is to find a willing buyer. Therefore, cryptocurrencies as currently implemented cannot be considered money or monetary value under the Money Services Act.

On the other hand, stablecoins that are pegged to sovereign currency may be considered a claim that can be converted into currency and thus fall within the definition of money or monetary value under Finance Code § 151.301(b)(3). In those instances where the stablecoin is backed by a sovereign currency reserve and a redemption right exists to the holder of the stablecoin, the holder has a claim to the sovereign backing the coin because the issuer has taken on the obligation to provide sovereign currency in exchange for the stablecoin at a later time (upon the holder's request).

STATEMENT OF POLICY

Because cryptocurrency is not money under the Money Services Act, receiving it in exchange for a promise to make it available at a later time or different location is not money transmission. Consequently, absent the involvement of sovereign currency in a transaction, no money transmission can occur. However, when a cryptocurrency transaction does include sovereign currency, it may be money transmission depending on how the sovereign currency is handled. A licensing analysis will be based on the handling of the sovereign currency.

To provide further guidance, the regulatory treatment of some common types of transactions involving cryptocurrency can be determined as follows.

- Exchange of cryptocurrency for sovereign currency between two parties is not money transmission. This is essentially a sale of goods between two parties. The seller gives units of cryptocurrency to the buyer, who pays the seller directly with sovereign currency. The seller does not receive the sovereign currency in exchange for a promise to make it available at a later time or different location.
- Exchange of one cryptocurrency for another cryptocurrency is not money transmission. Regardless of how many parties are involved, there is no receipt of money, and therefore no money transmission occurs.
- Transfer of cryptocurrency by itself is not money transmission. Because cryptocurrency is not money or monetary value, the receipt of it in exchange for a promise to make it available at a later time or different location is not money transmission. This includes intermediaries who receive cryptocurrency for transfer to a third party, and entities who, akin to depositories, hold cryptocurrency on behalf of customers.
- Exchange of cryptocurrency for sovereign currency through a third-party exchanger is generally money transmission. For example, most Bitcoin exchange sites, such as the failed Mt. Gox, facilitate exchanges by acting as an escrow-like intermediary. In a typical transaction, the buyer of cryptocurrency sends sovereign currency to the exchanger who holds the funds until it determines that the terms of the sale have been satisfied before remitting the funds to the seller. Irrespective of its handling of the cryptocurrency, the exchanger conducts money transmission by receiving the buyer's sovereign currency in exchange for a promise to make it available to the seller.

- Exchange of cryptocurrency for sovereign currency through an automated machine is usually but not always money transmission. For example, several companies have begun selling automated machines commonly called “Bitcoin ATMs” that facilitate contemporaneous exchanges of bitcoins for sovereign currency. Most such machines currently available, when operating in their default mode act as an intermediary between a buyer and seller, typically connecting through one of the established exchange sites. When a customer buys or sells bitcoins through a machine configured this way, the operator of the machine receives the buyer's sovereign currency in exchange for a promise to make it available to the seller. However, it is worth noting that at least some Bitcoin ATMs can be configured to conduct transactions only between the customer and the machine's operator, with no third parties involved. If the machine never involves a third party, and only facilitates a sale or purchase of Bitcoins by the machine's operator directly with the customer, there is no money transmission because at no time is money received in exchange for a promise to make it available at a later time or different location.

In contrast, because a sovereign-backed stablecoin may be considered money or monetary value under the Money Services Act, receiving it in exchange for a promise to make it available at a later time or different location may be money transmission. A licensing analysis will turn on whether the stablecoin provides the holder with a redemption right for sovereign currency thus creating a claim that can be converted into money or monetary value. This is true regardless whether the redemption right is expressly granted or implied by the issuer.

A virtual currency business that conducts money transmission must comply with all applicable licensing provisions of Finance Code Chapter 151 and of Title 7, Texas Administrative Code, Chapter 33. In addition, several considerations should be highlighted. First, because a money transmitter conducting virtual currency transactions conducts business through the Internet, the minimum net worth requirement under Finance Code §151.307 is \$500,000.⁶ Be advised that the Commissioner may increase the required net worth up to a maximum of \$1,000,000 based on the factors set out in §151.307(b). Second, a license holder may not include virtual currency assets in calculations for its permissible investments under Finance Code §151.309. Lastly, pursuant to Finance Code §151.203(a)(3) the Commissioner requires that license applicants who handle virtual currencies in the course of their money transmission activities must submit a current third-party security assessment of their relevant computer systems. Because the new technological paradigm created by cryptocurrencies has brought with it new risks for the consumer, it is incumbent on a license applicant to demonstrate that all virtual currency is secure while controlled by the applicant. Since security of a company's virtual currency operation is dependent upon the integrated components of its operations, the scope of the required independent third-party assessment, audit, test or combination of a license applicant must include:

- Network security;
- Website and web application security;
- Application server security;
- Virtual currency wallet infrastructure security and controls;

⁶ Under §151.307(a), a minimum net worth of \$500,000 is required if a business operates through five or more locations. It has been the Department's policy that license holders operating through the Internet are considered to be in more than five locations. See <https://www.dob.texas.gov/applications-forms-publications/notice-applicants#netw>.

- Information security policy assessment; and
- Application development controls and policy assessment.