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TO THE HOUSE COMMITTEE ON
INTRASTATE COMMERCE

TWENTY-NINTH LEGISLATURE
Regular Session of 2018

Wednesday, March 14, 2018
9:00 a.m.

TESTIMONY ON SENATE BILL NO. 3082 S.D. 1, RELATING TO VIRTUAL CURRENCY.

TO THE HONORABLE TAKASHI OHNO, CHAIR, AND MEMBERS OF THE COMMITTEE:

The Department of Commerce and Consumer Affairs ("Department") appreciates the opportunity to testify on S.B. 3082 S.D. 1, Relating to Virtual Currency. My name is Iris Ikeda, and I am the Commissioner of Financial Institutions for the Department's Division of Financial Institutions ("DFI"). The Department prefers this bill and supports this bill with two suggested amendments explained below. This bill is substantially similar to section 2 of companion H.B. 2257, H.D. 2 (pages 61, line 8, through page 87, line 15 of H.B. 2257, H.D. 2).

S.B. 3082 S.D. 1 extends the Money Transmitters Act, Hawaii Revised Statutes ("HRS") chapter 489D, to expressly apply to persons engaged in the transmission of virtual currency. This bill makes clear that virtual currency businesses are subject to regulation under HRS chapter 489D. It specifically authorizes DFI to accept like-kind virtual currency as permissible investments. This addresses the concern of some virtual currency money transmitters that they cannot afford to hold cash and cash-like permissible investments to cover their virtual currency transactions, as HRS chapter

489D currently requires. The bill warns consumers before they transact, that virtual currency is volatile by nature, and that they may lose all their virtual currency which is not backed or insured by the government. The bill provides a framework for DFI to regulate this still emerging industry under the Money Transmitters Act, including requirements for licensure, license renewal, examination, record keeping, reporting, prohibited practices, sanctions and penalties.

Amendments

The Department respectfully requests these two amendments to this bill:

1. Amend subsection (2) of the definition of "outstanding payment obligation" on page 5, lines 6-10, to read as follows:

   (2) All other [~~outstanding~~] money transmission obligations [~~of~~] that the licensee [~~issued,~~] has contracted in the United States to transmit, deliver or instruct to be to be delivered, that have not been fully performed by the licensee.

   This will clarify that the term applies to money transmitter transactions initiated in the United States; and

2. Change the effective date to "July 1, 2018."

The Department believes this bill addresses the requirement of the law that prevented virtual currency companies from applying for licensure. The Department believes this bill will allow virtual currency companies to become licensed and operate in Hawaii and provide protections to consumers. Thank you for the opportunity to testify in support of this bill and the two amendments suggested above.

TO: **HAWAII SENATE & HOUSE OF REPRESENTATIVES**

FROM: **INTERNATIONAL BLOCKCHAIN REGULATORY ALLIANCE**

RE: **MEMORANDUM - H.B. 2257, S.B. 2129 & S.B. 3082 RELATING TO VIRTUAL CURRENCY**

DATE: **March 14, 2018**

TO THE HONORABLE SENATORS AND REPRESENTATIVES OF THE STATE OF HAWAII:

The International Blockchain Regulatory Alliance ("IBRA"), through its representative, Anatha Technologies ("Anatha"), an Oahu, Hawaii based member of the IBRA, appreciates the opportunity to testify on H.B. 2257, S.B. 2129 and S.B. 3082, Relating to Virtual Currency. My name is Ian Luthringer, and I am Chairman of the Board of Directors of the IBRA, in addition to being General Counsel and Chief Compliance Officer for Anatha. The IBRA respectfully opposes H.B. 2257, S.B. 2129 and S.B. 3082.

Blockchain Technology and Industry Overview

Blockchain technology is the underpinning of a blockchain network, which may be defined as a ledger of facts, replicated and distributed across multiple computers assembled in a peer-to-peer network. Facts can be anything from an agreed upon value of exchange to specific content created by a user. All communication inside the network takes advantage of cryptography to securely identify the sender and the receiver. When a user wants to add a fact to the ledger, a consensus forms in the network to determine where this fact should appear in the ledger; this consensus is called a block. This network is essentially a chain of computers that must all approve an exchange before it can be verified and recorded.

> *The practical consequence […is…] for the first time, a way for one Internet user to transfer a unique piece of digital property to another Internet user, such that the transfer is guaranteed to be safe and secure, everyone knows that the transfer has taken place, and nobody can challenge the legitimacy of the transfer. The consequences of this breakthrough are hard to overstate.*
>
> - Marc Andreessen

A cryptocurrency (like Bitcoin) is not a currency in the traditional sense, it is a digital record of value that uses blockchain technology for allocating ownership of such record, securely

storing evidence of such ownership, and permitting the secure transfer of such value between users of the blockchain network on which such value is stored, by permitting reallocation of ownership of such record from one user to another. Unlike with traditional currencies and accounting ledgers, cryptocurrencies stored on a blockchain cannot be forged and therefore the accuracy of the records is infallible. Moreover, unlike traditional currencies, the value attributed to a cryptocurrency can come from the actual transferrable information recorded/stored therein, not from an assigned value dictated by a government or central bank. In addition, since there is no central bank or corporation issuing and controlling cryptocurrencies, they are essentially protected from interference and manipulation. Due to the decentralized nature of blockchain technology, it would take a consensus of a majority of the particular blockchain network's users (everyone that holds the particular cryptocurrency) to alter the records of ownership – a true democratic system.

Cryptocurrencies are not the only functionality of blockchain technology. Yes, cryptocurrencies are the first and most well-known use case of blockchain technology, and do provide a solution to the obstacles traditional currencies pose to universal access to global economic markets. This functionality is key to the dissemination of wealth and consequent alleviation of poverty, corruption and oppressive regimes. However, as significant as this is, blockchain technology offers even more, such as: secure identity verification; permanent immutable document storage and record keeping; fraud proof transactions and title transfers (instantaneously without the need for third-party involvement); truly transparent accounting of corporate operations; zero proof, real time auditing; elimination of transaction intermediaries and financial waste; and much more.

In general, the blockchain industry is a sector of economic development and technology innovation that focuses on creating networks and applications utilizing blockchain technology. Some entities engaged in the industry formally structure as corporations, limited liability companies, nonprofits or other business entity that retains a certain amount of control over the application they created and launched on a blockchain network. This mimics the traditional methodology of centralization in business endeavors and results in the entity being able to capture profits from the application. Conversely, other applications may be created by an individual or group of unincorporated individuals, or even a formally structured business entity, that creates and launches the application, but after launch has no more control over the application than other users of the application. This methodology is a decentralized open-source framework that allows the community of users to collectively make adjustments to the application, but inhibits any one or minority group of users to alter the application. Bitcoin, the first cryptocurrency and blockchain network, which was the first instance of general employment of blockchain technology, was created and launched utilizing such methodology. No single person, group or entity, owns or controls Bitcoin; it is an open-sourced blockchain network that functions mainly as a cryptocurrency.

Quite simply, the complexity of the blockchain industry is unparalleled throughout history. It incorporates characteristics of all existing industries into its framework, and therefore cannot be categorized into one existing industry. This complex nature should be celebrated and nurtured with deference to its uniqueness, for it ushers in a new age of efficiency, trusted transactions and information exchanges, transparency and compliance, and above all, equality.

IBRA Overview

The IBRA is an organization comprised of blockchain industry participants, whom are all dedicated to establishing effective uniform regulations for the blockchain industry. Such blockchain industry participants include, but are not limited to, blockchain: technology, token sales and initial coin offering consultants; developers and engineers; entrepreneurs and investors; service providers; attorneys and accountants; digital asset funds; investment advisers and managers; brokers and dealers; exchange operators; cryptocurrency wallet providers; and public interest and proponent groups.

The underlying principles that form the basis of the IBRA organization are: 1) blockchain technology is the next stage of technology expansion in the digital information age; 2) blockchain technology should be utilized to establish social and economic equality amongst all people of the world, thereby meaningfully improving quality life in a sustainable manner; 3) blockchain technology based products and services should be developed in such a way as to protect the rights, interests and inherent value of all people of the world; 4) effective regulation of the blockchain industry is essential to the realization of social and economic equality amongst, and the protection of the rights, interests and inherent value of, all people of the world.

Each member of the IBRA is considered a representative of the IBRA, and promises to adhere to the principles set forth above, and to take action to educate and promote such principles within and without the blockchain industry.

H.B. 2257, S.B. 2129 & S.B. 3082 - Overview and Legal Implications

Part I of H.B. 2257 and S.B. 2129 seek to regulate virtual currency businesses by establishing a new Chapter to the Hawaii Statutes, which would be known and cited as the Uniform Regulation of Virtual Currency Businesses Act (the "Act"). Part II of H.B. 2257 and S.B. 3082 seek to regulate virtual currency by introducing amendments, which are essentially language taken from the Act, to Section 489D-4, Hawaii Statutes, concerning money transmitter businesses (the "Amendment").

It is not our intent to criticize the Act or the Amendment, in effort to prevent regulation, we simply desire to point out a few of the many issues present in the Act and Amendment, which will make it impossible to effectively enforce when you consider the nature of the blockchain industry. We applauded the drafters of the Act and Amendment for taking the initiative to promote meaningful regulation, but we hope the Act and Amendment are the first steps in starting the dialogue to reach a truly effective regulatory framework. Taking such an approach will prevent unnecessary and costly litigation, and future amendments, to rectify the Act's and Amendment's shortcomings.

Part I H.B. 2257 & S.B. 2129

As a threshold issue, the Act ineffectively defines "virtual currency," due to the overbroad and unduly burdensome reach of the definition (emphasis added below):

> "Virtual currency" means a ***digital representation of value*** that is used as a medium of exchange, unit of account, or store of value, and is not legal tender, regardless of whether denominated in legal tender. "Virtual currency" does not include:
>
> (1) A transaction in which a merchant grants, as part of an affinity or rewards program, value that cannot be taken from or exchanged with the merchant for legal tender, bank credit, or virtual currency; or
>
> (2) A digital representation of value issued by or on behalf of a publisher and used solely within an online game, game platform, or family of games sold by the same publisher or offered on the same game platform.

The use of the phrase "digital representation of value" incorporates every single item of value that is put into digital format. The attempt to limit the application of such a broad term of reference, by requiring it to also be "used as a medium of exchange, unit of account, or store of value," is meaningless to say the least. This would require a song performed by a teenager and recorded and stored on their computer, to be categorized as "virtual currency," since it is foreseeable that the teenager may exchange it with a friend or a third-party for legal tender, Bitcoin, a baseball card, tutoring assistance, another digital work of art, or any number of other items put into digital format. The limited exclusions from the definition, identified as (1) and (2), are very specific use cases, which should be excluded from the definition, but do very little to reduce the inappropriate breadth of the definition. Moreover, the breadth of the definition integrates what would clearly be considered protected speech under the First Amendment of the U.S. Constitution, such as the teenagers song. See discussion below.

Furthermore, a "virtual currency business" is not defined in the Act. Instead, the Act attempts to define "virtual currency business activity". Due to the breadth of the definition of "virtual currency business activity," which incorporates the definition of "virtual currency," the definition does little to negate the fact that the Act oversteps its regulatory purpose and authority. The definition is (emphasis added):

> "Virtual currency business activity" means:
>
> (1) Exchanging, transferring, or storing ***virtual currency***, or engaging in virtual currency administration, whether directly or through an agreement with a virtual currency control services vendor . . .

The Act again attempts to limit its overreaching breadth under § -3 Scope, in which the Act sets forth the instances when the Act applies and when the Act does not apply. In § -3(a) the Act provides (emphasis added):

> Except as otherwise provided in subsection (b) or (c), this chapter governs the virtual currency business activity of a person, ***wherever located***, that engages in or holds itself out as engaging in the activity with or on behalf of a resident.

The foregoing provision extends the reach of the Act even further by asserting it applies to all potential virtual currency business activity, regardless of the parties' location, so long as one of the parties is a resident of Hawaii.

Violation of The Commerce Clause

In light of the foregoing, aside from violating the requirement that a statute be pointed in its application, the Act blatantly violates the Commerce Clause -Article 1, Section 8, Clause 3 of the U.S. Constitution. The Commerce Clause gives Congress the power "to ***regulate commerce*** with ***foreign nations***, and ***among the several states***, and with the ***Indian tribes***." (emphasis added) By not limiting the Act to virtual currency business activity conducted solely within the State of Hawaii, the Act attempts to grant the State of Hawaii the power reserved to Congress – the power to regulate virtual currency business activity between residents of the State of Hawaii and residents of foreign nations, other states and Indian tribes. This flaw alone will result in the act being unenforceable as to any such virtual currency business activity.

In § -3(b) the Act exempts fourteen (14) enumerated instances from the scope of the Act. None of these instances rectify the violation of the Commerce Clause created by § -3(a). This is exceptionally troublesome since the § -3(b) states that the Act shall not apply to the extent that the Electronic Fund Transfer Act, Securities Exchange Act and Commodities Exchange Act apply. All three of these acts are examples of Congress exercising its power under the Commerce Clause. So, the Act essentially admits the power of Congress to regulate interstate commerce, but in the same breath ignores such power by permitting the State of Hawaii to regulate interstate virtual currency business activity, which is by all accounts, interstate commerce.

§ -3(b)(7) does provide an exemption, that appears at first blush to resolve some of the overbroad nature of the Act, as it applies to personal transactions. It provides an exemption for a person "creating, investing, buying or selling, or obtaining virtual currency as payment for the purchase or sale of goods or services" on its own behalf, or for personnel, family, household or academic purposes. Since "person" is defined by the Act to include "an individual, partnership, estate, business or nonprofit entity, or other legal entity," this exemption appears to exempt any activity by any of the foregoing to create, invest in, buy or sell, or obtain for use as a payment method, virtual currency, if done on the person's own behalf or for personnel, family, household or academic purposes. This provision is a positive step in resolving the overreaching scope of the Act, but it still does not limit the definition of virtual currency. So, virtual currency would still include the song performed and recorded by the teenager in our earlier hypothetical. Yes, that example now appears to be permissible under § -3(b)(7), but what about a company that sells digitally recorded works of art as a broker, it would still be subject to the Act, affirming that the reach of the Act is too extensive, unless the State of Hawaii is attempting to regulate brokers of digital works of art under the Act.

Violation of The Contract Clause

Furthermore, as should be clear from the foregoing analysis, the Act is essentially attempting to regulate not only virtual currency business activities, but due to the overbroad definitions and inadequacy of proper limitations of scope, various forms of property and property rights. As discussed above, cryptocurrencies, which may fall within the definition of virtual currencies under the Act, are not currencies at all, but instead are more akin to property, which by its nature stores value. The fact that the Act includes "store of value" within the definition of virtual currency attests to the Act's attempt to regulate property. It is well understood that private property rights are a constitutionally protected interest of every U.S. citizen. The Contract Clause, Article 1, Section 10, Clause 1 of the U.S. Constitution, provides that "(n)o state shall . . . pass any . . . law impairing the obligation of contracts." The Contract Clause is a well-known tool by which the U.S. Constitution's limit the states' ability to pass regulations impacting the economy. Here, the Act attempts to eliminate the right of the residents of the State of Hawaii (including but not limited to individuals, partnerships and companies), as well as the residents of all other locations around the world (including but not limited to individuals, partnerships and companies), from contracting with residents of the State of Hawaii, when the contemplated transaction concerns virtual currency. Again, the narrow limitations and exemptions within the Act do little to nothing to remediate its prohibition on the right to contract and the consequent violation of the Contract Clause.

Violation of The First Amendment

Moreover, the Act violates the First Amendment to the United States Constitution, which provides:

> Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the ***freedom of speech***, or of the press; or the right of the people peaceably to assemble, and to petition the government for a redress of grievances.

It should be noted that the Act does not only abridge the freedom of speech, it also abridges the freedom of press, the right of the people peaceably to assemble and petition the government for redress of grievances. Additionally, it prohibits the free exercise of religion.

As to freedom of speech, it should be very clear how the Act violates the First Amendment. The Supreme Court of the United States stated in *Packingham v. North Carolina*, 137 S. Ct. 1730 (2017):

> A fundamental First Amendment principle is that all persons have access to places where they can speak and listen, and then, after reflection, speak and listen once more . . . While in the past there may have been difficulty in identifying the most important places (in a spatial sense) for the exchange of views, today the answer is clear. It is cyberspace — the "vast democratic forums of the Internet" . . .

> While we now may be coming to the realization that the Cyber Age is a revolution of historic proportions, we cannot appreciate yet its full dimensions and vast potential to alter how we think, express ourselves, and define who we want to be. The forces and directions of the Internet are so new, so protean, and so far reaching that courts must be conscious that what they say today might be obsolete tomorrow. This case is one of the first this Court has taken to address the relationship between the First Amendment and the modern Internet. As a result, the Court must exercise extreme caution before suggesting that the First Amendment provides scant protection for access to vast networks in that medium.

It is beyond any argument that blockchain networks, such as Bitcoin and all other cryptocurrencies, offer the same functionality as the Internet, regarding the global exchange of information, but with greater security. Blockchain networks are often referred to as the next stage in the evolution of the Internet. Like the Internet, blockchain networks exist in cyberspace. Consequently, it is safe to say that the Supreme Court will give blockchain networks the same level of deference as it has chosen to give to the Internet when considering violations of the First Amendment, as they are one-in-the-same – digital networks that provide for the sharing of information through cyberspace.

Moreover, it has been expressly held that computer code, which includes the cryptography inherent in all cryptocurrencies, is protected speech under the First Amendment. See *Bernstein v. United States Department of Justice*, 922 F. Supp. 1426 (N.D. Cal. 1996), *et. seq*. In *Bernstein*, the Plaintiff sought determine whether he had the right to distribute encryption software of his own creation, using cryptography, over the Internet. His software converted a one-way "hash function" into a private-key encryption system, which could be decoded only by whoever holds the private key and transferred to another upon an exchange of their private keys. This is essentially the same process behind all cryptocurrencies utilizing the cryptography private key framework. This case present a strong position for any future litigation concerning whether regulation of cryptographic speech (such as cryptocurrencies) infringes on the First Amendment. Consequently, at a very minimum, the Act would likely be found to violate the First Amendment for the very simple reason that it seeks to limit access to, and the exchange of, the information (speech – cryptographic speech) inherently a part of every cryptocurrency, without establishing a permissible reason to do so.[1]

An argument that the Act is meant to protect consumers and curtail criminal activity will certainly not deemed "narrowly tailored to serve a significant governmental interest." See *Packingham v. North Carolina*, 137 S. Ct. 1730 (2017) ("Like other inventions heralded as advances in human progress, the Internet and social media will be exploited by the criminal mind . . . However, the assertion of a valid governmental interest cannot, in every context, be insulated

[1] See *Bernstein v. United States Department of Justice*, "Government efforts to control encryption thus may well implicate not only the First Amendment rights of cryptographers intent on pushing the boundaries of their science, but also the constitutional rights of each of us as potential recipients of encryption's bounty. Viewed from this perspective, the government's efforts to retard progress in cryptography may implicate the Fourth Amendment, as well as the right to speak anonymously, see *McIntyre v. Ohio Elections Comm'n*, 514 U.S. 334, 115 S.Ct. 1511, 1524, 131 L.Ed.2d 426 (1995), the right against compelled speech, see *Wooley v. Maynard*, 430 U.S. 705, 714, 97 S.Ct. 1428, 51 L.Ed.2d 752 (1977), and the right to informational privacy, see *Whalen v. Roe*, 429 U.S. 589, 599-600, 97 S.Ct. 869, 51 L.Ed.2d 64 (1977)."

from all constitutional protections.") Ruling that a law prohibiting sex offenders from accessing social media sites was a violation of the First Amendment, the Court reasoned in part that "the State has not met its burden to show that this sweeping law is necessary or legitimate to serve its purpose of keeping convicted sex offenders away from vulnerable victims. No case or holding of this Court has approved of a statute as broad in its reach." As in *Packingham*, the Act is clearly overbroad and unduly burdensome due to the all-inclusive breadth of its definitions, and consequently, application.

With that in mind, recall the definition of virtual currency includes a "***digital representation of value*** that is ***used*** as a ***medium of exchange***, ***unit of account***, or ***store of value***." (emphasis added)

First let's reiterate the fact that every "digital representation of value" is simply value represented in digital form, and so long as it's digital form can be saved and accessed at a later date, such "digital representation of value" will be a "store of value," since the only requirement to be a "store of value" is to retain value for future use. This aspect of the definition alone creates the high probability First Amendment rights will be infringed by the Act, since the breadth of the definition would inhibit speech in digital form, such as that set forth in a person's written philosophy put into an e-book. Turn that into an e-book expressing that person's religious philosophy, now the Act also inhibits the free exercise of religion.

The Act's requirement for an "exchange" to be present for the Act to apply would be satisfied due to the broad definition of "exchange" (emphasis added):

> "Exchange", used as a verb, means to assume ***control*** of virtual currency from or on behalf of a resident, at least momentarily, to sell, trade, or convert:
>
> (1) Virtual currency for legal tender, bank credit, or one or more forms of virtual currency; or
>
> (2) Legal tender or bank credit for one or more forms of virtual currency.

"Control" is partly defined as:

> (1) When used in reference to a transaction or relationship involving virtual currency, power to execute unilaterally or prevent indefinitely a virtual currency transaction; . . .

So, in the above example, an "exchange" of the e-book would occur if a person, other than the author, had the power to unilaterally sell, trade, or convert the e-book for legal tender (USD) or other virtual currency (another e-book, another digital work of art, an I.O.U. in digital form, or cryptocurrency). The negative consequences of this definition scheme are obviously exhaustive. It is almost like a digital book burning using economic regulation – if you cannot burn the book, you can perhaps make it illegal to disseminate without a license, thereby providing an enforcement

framework that ultimately dissuades not only dissemination without a license, but also dissuades the very creation of the e-book due to the natural human behavioral response to avoid fear, which regulation ultimately generates in every society. This is a dramatic analogy, and most likely not the intent of the drafters of the Act, but it is at least an indirect consequence of the Act. Quite simply, this Act is an unqualified curtailment of the freedom of speech.

Second, let us address the First Amendment implications of the inclusion of a "medium of exchange" within the definition of virtual currency. As with "store of value," since the term "medium of exchange" is not defined, we assume the authors of the Act intended the ordinary meaning: anything used as a measure of value in exchange for goods and services. This definition can of course include anything that is a "store of value" if such thing can be exchanged for goods or services. So long as such thing is in digital form it would qualify as a virtual currency under the Act. Consequently, the above analysis applies to "medium of exchange" as well. This points out a very important distinction between legal tender (USD) and cryptocurrency, while both can function as a "medium of exchange" and a "store of value," cryptocurrency can also function as a store of information (the ability to store information and exchange such information is what gives cryptocurrency its real value). This point cannot be stressed too much since it is the ability of cryptocurrency to function as a medium of exchange for digital information that makes it akin to the Internet, and consequently, according to the Supreme Court, deference as speech that may be protected under the First Amendment. So, even if the Act only included "medium of exchange" under the definition of virtual currency, it would still be infringing freedom of speech under the First Amendment.

Finally, we address the First Amendment implication of the inclusion of a "unit of account" within the definition of virtual currency. Again, as with "store of value" and "medium of exchange," since the term "unit of account" is not defined, we assume the authors of the Act intended the ordinary meaning: a unit of measurement for defining, recording, and comparing value. Here, it is clear that a cryptocurrency is a digital representation of value, but it can be argued that cryptocurrency is not "a unit of measurement for defining, recording and comparing value," since almost all cryptocurrencies have trading pairs with United States Dollars or Bitcoin, which has a trade value paired with United States Dollars. At the end of the day, for all practical purposes the value of cryptocurrencies is still defined, recorded and compared in terms of United States Dollars (or other fiat currency). For example, a holder of Bitcoin may have 10 Bitcoin, but the value of Bitcoin must be established by referring to the price of Bitcoin in United States Dollars. Consequently, if the person went to purchase something with Bitcoin, the value of the item to be purchased would be established in USD and then that amount would be divided by the price of Bitcoin at that moment in time to determine the number of Bitcoins that must be exchanged to complete the purchase. The inability of cryptocurrency to function as a "unit of account" is a consequence of the volatility of cryptocurrency prices. Over time prices should stabilize and transactions may be able to be completed without reference to fiat currency as a unit of account, but until such time cryptocurrency will not qualify as a "unit of account." This is the case for all other digital representations of value, except perhaps for digital wire transfers of fiat currency and similar items. Consequently, it is unclear why the authors even included "unit of account" within the definition of virtual currency, and it is therefore pointless to complete a First Amendment analysis, due to irrelevance.

At this point, we know that the Supreme Court has deemed cryptography and the Internet, protected under the First Amendment, and that cryptocurrencies are blockchain networks (which are, for all intents and purposes, the same as the Internet) that use cryptography as part of their coding structure and method of communicating information. Furthermore, we understand that a law seeking to regulate First Amendment rights must be narrowly tailored to protect a significant government interest, and laws with extensive breadth will typically not meet this requirement. Considering the foregoing discussion, it appears that the Act would certainly fail a First Amendment challenge.

When we start choosing what speech is permissible and what speech is not permissible, we are flirting with the establishment of a totalitarian regime, where any opposition to the regime will be held to be detrimental to public welfare, providing the regime with a tool to eliminate challenges to its control; thereby, eroding democracy and all ensuing rights of the people. The Supreme Court warns that "[t]he nature of a revolution in thought can be that, in its early stages, even its participants may be unaware of it. And when awareness comes, they still may be unable to know or foresee where its changes lead." *Id*. The wisdom in this statement makes it very clear that an attempt to regulate the decentralized exchange of information using blockchain networks is premature at this time, and would be paramount to attempting to regulate the Internet in the early 1990s. As time passed we came to understand the importance of the Internet as a tool of self-expression, communication and information exchange. The same will happen regarding blockchain networks, and any regulation seeking to limit access, directly or indirectly, will fall under strict scrutiny upon the insistence of public outcry. As the public becomes more educate as to the truth of the nature and utility of blockchain technology and blockchain networks, they will certainly become an enraged mass, striking out with vengeance against all that seek to limit their access to the most empowering technology known for direct, truthful, decentralized information exchange – the most prominent proponent of freedom of speech we have ever known.

Part II H.B. 2257 & S.B. 3082

The Amendment is formidable attempt to amend the money transmitter law to regulate "virtual currency" under its purview, but it unfortunately utilizes language pulled directly from the Act, including without limitation, the definitions of "virtual currency," "exchange," and "control." Consequently, the Amendment encounters the same legal obstacles addressed above regarding the Act.

As drafted, without the Amendment, Section 489D appears to be an enforceable statutory scheme, regulating money transmitter businesses within the State of Hawaii for an admirable purpose:

> **[§489D-2] Purpose.** It is the intent of the legislature to establish within the State a licensure system to ensure the safe and sound operation of money transmission businesses, to ensure that these businesses are not used for criminal purposes, to promote confidence in the State's financial system, and to protect the public interest. (emphasis added)

However, addition of the Amendment, takes an otherwise valid and enforceable statutory scheme and subjects it to attack on grounds of being overbroad, unduly burdensome and an infringement of the Commerce Clause, Contract Clause and First Amendment of the U.S. Constitution, for the same reasons discussed above concerning the Act. The purpose set forth in Section 489D-2 does little to remediate the constitutional challenges, since the Supreme Court said in *Packingham v. North Carolina*, 137 S. Ct. 1730 (2017), even laws meant to protect consumers and curtail criminal activity will not be deemed "narrowly tailored to serve a significant governmental interest," if the breadth of the law reaches otherwise protected constitutional rights. As discussed above, due to the far reach of the definitions of the Amendment, Section 489D would end up inhibiting not only the right of criminals, but also the right of law abiding citizens. Consequently, the Amendment results in Section 489D being unenforceable.

The introduction of a severability clause by some of the proponents of the Amendment could almost be considered an acknowledgement of this fatal flaw. The approach of attempting to enforce Section 489D with the Amendment, and allowing the Amendment to be severed from Section 489D by a court of competent jurisdiction, is certainly not within the best interest of the public or the reputation of the State of Hawaii legislature. The public expects the State of Hawaii to only enact laws that are well thought out and passed with the good faith belief that such laws preserve the constitutional rights of the people. Inclusion of a severability clause, when attempting to regulate new evolving technology, is a good sign that the legislature is not sure what they are regulating and the ultimate consequences of such regulation. For this reason, the Supreme Court in *Packingham v. North Carolina* warned that "extreme caution" should be exercised when determining whether regulation of new technology infringes on constitutional rights. A wait and see approach would clearly be favored by the Supreme Court – take time, become educated about the technology and its impact on all aspects of life, including constitutional rights, let the technology evolve with minimal narrowly tailored regulation and adjust, if necessary. The alternative is to enact overly restrictive regulation that infringes constitutional rights and results in litigation.

In addition, money transmitter law has traditionally been used to regulate exchanges of "money" (traditional currency), not property and information (including without limit, protected speech). The very fact that the Amendment seeks to change this framework to expand the reach of a statutory scheme built for a specific purpose is a red flag. The proper action would be to develop a new statutory scheme to regulate "virtual currency." The Act attempt to do this, but is defective as discussed above. It is an understandable mistake, to group cryptocurrency under Section 489D, given the populace is using the term cryptocurrency, and the human mind wants to quickly group it with traditional currency. However, this automatic reaction can be overcome by meaningful inquiry into the true nature of cryptocurrency, as information that is of value, and not merely a representation of value like traditional currency.

Policy Considerations

First and foremost, Bitcoin and all other cryptocurrencies are currently legal in every single state in the United States, including Hawaii. There is absolutely no law to the contrary. There is very good reason for this, a law that makes cryptocurrencies illegal would be akin to a law that makes the Internet illegal, which would, in essence, be a law making the exchange of information

and personal property illegal. Aside from being unconstitutional, such a law would be next to impossible to enforce, since true cryptocurrencies like Bitcoin are not controlled by anyone, like the Internet – they simply exist as a global network accessible to all. To overcome this obstacle, law makers would have to fabricate a basis grounded in public health and welfare.

As drafted, the Act fails to provide any meaningful protection to the residents of Hawaii. In facts, as discussed above, the Act and Amendment constrain constitutional rights, and invite the establishment of an oligopoly that will prevent a free market economy when it comes to virtual currency. The inevitable result of an oligopoly is the concentration of wealth in a few, and consequently, the ability of these few to dictate how the blockchain industry would be accessible by the public.

The current drafts of the Act and Amendment do not instill confidence in the government, since it appears the authors do not have a clear understanding of the subject matter they are seeking to regulate. The Act and Amendment are drafted more like you would expect a contract to be drafted, with broad sweeping language that is meant to catch all potentialities, foreseeable and unforeseeable. It is understandable why the authors chose to draft this way, given the uncertainty surrounding the future of the blockchain industry and blockchain technology. It leaves us to believe that the authors may not have a complete understanding of the subject matter of the Act; consequently, using the broad language to make up for their lack of understanding of blockchain technology. This is a very real and unfortunate possibility given the complex nature of blockchain technology, its functionality, uses, and foreseeable and unforeseeable future.

Proposed Action and Revisions

Considering the foregoing discussion, it is apparent that the Act is beyond repair, and must be completely redrafted to resolve the constitutional challenges littered throughout its provisions.[2] As good intentioned as it may be, the Act is unfortunately a premature attempt to regulate blockchain technology, and fails to take into consideration the rights reserved for every U.S. citizen under the U.S. Constitution, and the general principles of a democratic society.

Furthermore, since the same deficiencies inherent in the Act have been incorporated in the Amendment by inclusion of the defective definitions, the Amendment suffers from the same fatal U.S. Constitutional challenges, and therefore should also be struck all together.

Fortunately, neither the Act, nor the Amendment, is necessary for the State of Hawaii to further its interests of curtailing criminal activity, preserving confidence in the financial system, and protecting the public interest. The State of Hawaii has already enacted legislation that will serve these interests in regard to virtual currency business activity, through Chapter 708A – Money Laundering, Hawaii Revised Statutes. Such Chapter achieves the goals of curtailing criminal activity, preserving confidence in the financial system, and protecting the public interest by making

[2] We only addressed the first fatal flaws to appear in the Act – overbroad definition framework, and violations of the Commerce Clause, Contract Clause and First Amendment of the U.S. Constitution. There are countless other concerns, including without limitation, the arbitrary tiered system of application, biased exemptions, violation of the Fourth Amendment of the U.S. Constitution, the right to speak anonymously, see *McIntyre v. Ohio Elections Comm'n*, 514 U.S. 334, 115 S.Ct. 1511, 1524, 131 L.Ed.2d 426 (1995), the right against compelled speech, see *Wooley v. Maynard*, 430 U.S. 705, 714, 97 S.Ct. 1428, 51 L.Ed.2d 752 (1977), and the right to informational privacy, see *Whalen v. Roe*, 429 U.S. 589, 599-600, 97 S.Ct. 869, 51 L.Ed.2d 64 (1977).

it a crime in certain situations for a person to transmit, transfer, receive or acquire, or conduct a transaction or business involving virtual currency (including Bitcoin and other cryptocurrencies) when the person knows the virtual currency is the proceeds of criminal activity. Specifically, Chapter 708A provides:

> **§708A-3 Money laundering; criminal penalty.** (1) It is unlawful for any person:
>
> (a) Who knows that the property involved is the proceeds of some form of unlawful activity, to knowingly transport, transmit, transfer, receive, or acquire the property or to conduct a transaction involving the property, when, in fact, the property is the proceeds of specified unlawful activity:
>
> (i) With the intent to promote the carrying on of specified unlawful activity; or
>
> (ii) Knowing that the transportation, transmission, transfer, receipt, or acquisition of the property or the transaction or transactions is designed in whole or in part to:
>
> (A) Conceal or disguise the nature, the location, the source, the ownership, or the control of the proceeds of specified unlawful activity; or
>
> (B) Avoid a transaction reporting requirement under state or federal law;
>
> (b) Who knows that the property involved in the transaction is the proceeds of some form of unlawful activity, to knowingly engage in the business of conducting, directing, planning, organizing, initiating, financing, managing, supervising, or facilitating transactions involving the property that, in fact, is the proceeds of specified unlawful activity:
>
> (i) With the intent to promote the carrying on of specified unlawful activity; or
>
> (ii) Knowing that the business is designed in whole or in part to:
>
> (A) Conceal or disguise the nature, the location, the source, the ownership, or the control of the proceeds of specified unlawful activity; or

(B) Avoid a transaction reporting requirement under state or federal law; or

(c) To knowingly conduct or attempt to conduct a financial transaction involving property represented to be the proceeds of specified unlawful activity, or property used to conduct or facilitate specified unlawful activity, with the intent to:

(i) Promote the carrying on of specified unlawful activity; or

(ii) Conceal or disguise the nature, the location, the source, the ownership, or the control of property believed to be the proceeds of specified unlawful activity.

"Property" is defined in Section 708A-2 of the Chapter, as "anything of value, including any interest, benefit, privilege, claim, or right with respect to anything of value, whether real or personal, tangible or intangible." The foregoing definition would clearly include all virtual currency (including Bitcoin and other cryptocurrencies). Consequently, individuals and business engaged in virtual currency business activity would be subject to criminal sanctions pursuant to the provisions of Chapter 708A. In that, the State of Hawaii has a mechanism by which to curtail criminal activity, preserve confidence in the financial system, and protect the public interest. An official public announcement would suffice to bring the public's, and industry participants', attention to the fact that Chapter 708A applies to transactions involving virtual currency.

Furthermore, any virtual currency (including Bitcoin and other cryptocurrencies) deemed to be a security would be regulated under the Chapter 485A – Uniform Securities Act, Hawaii Revised Statutes, as well as the U.S. Securities Act 1933 and potentially the U.S. Investment Company Act 1940 and all other federal securities regulation. Consequently, any transaction involving such virtual currency would be subject to the registration, disclosure, and reporting requirements of Chapter 485A, and such federal securities law. Citizens of the State of Hawaii would also be protected from fraudulent activity regarding such virtual currency pursuant to Part V – Fraud and Liabilities, Chapter 485A, as well as the corresponding federal securities laws concerning fraud and liability.

In addition, any transaction concerning virtual currency that is deemed a security or a commodity, which is conducted on a securities exchange or commodities exchange, respectively, would be subject to the U.S. Securities Exchange Act 1934 and U.S. Commodities Exchange Act 1936, respectively. Such acts prescribe for, amongst other things, registration of any securities and commodities listed on exchanges, disclosure and audit requirements, civil liability and criminal sanctions for prohibited acts.

Moreover, virtual currency business activity is subject to both state and federal consumer protection and antitrust legislation enacted to protect the public interest, including but not limited to Chapter 481A – Uniform Deceptive Trade Practice Act, Hawaii Revised Statutes, the U.S.

Sherman Act and the U.S. Federal Trade Commission Act of 1914. Together such acts provide a much more expansive, yet narrowly tailored and constitutionally tested, approach to regulating unlawful virtual currency business activity. These acts, coupled with money laundering regulation, provide the basis upon which the public will be protected from unlawful activity inherent in the growth and integration of blockchain technology into our everyday lives. The Act provides no additional benefit, and in fact, as discussed above, restricts the rights of the public – not protect them. As drafted, the Amendment does not provide a reasonable alternative or companion to the Act, offering no meaningful protection above that offered by existing consumer protection, antitrust and money laundering acts.

At this point in time, the solution is to acknowledge: 1) blockchain technology (including Bitcoin and other cryptocurrencies) is a new technology deeply ingrained with numerous rights, societal benefits and challenges; 2) as time passes we will gain a better understanding of blockchain technology and the role it will play in the lives of the public, the benefits it will provide and the challenges it will present; 3) blockchain technology itself cannot be regulated due to its inherent nature (much like the Internet); 4) regulation will need to be directed at how people access blockchain technology; 5) such regulation must be narrowly tailored to ensure it does not infringe upon constitutionally protected rights or the rights inherent in a democratic society; and 6) regulation should be meaningful and not duplicative.

In light of the foregoing, the State of Hawaii House of Representatives and Senate should consider opposing the Act and Amendment. If the Senate and House feel it is necessary to enact one or the other, the Amendment is the better alternative, but only with the revisions suggested herein below, which are intended to reduce the potential constitutional challenges and pitfalls of the Amendment:

Revisions to Definition of "Virtual Currency":

"Virtual currency" means a digital representation of value that:

(1) Is used as a medium of exchange, unit of account, ~~or~~ and store of value;

(2) Is not money, whether or not denominated in money.

"Virtual currency" does not include digital representations of value that:

(1) ~~Units of value that~~ are issued in affinity or rewards programs that cannot be redeemed for either money or virtual currencies; ~~or~~

(2) ~~Units of value that~~ are used solely within online gaming platforms that have no market or application outside of the gaming platforms;

(3) have value derived from information inherent therein, other than a measure of value; or

(4) have an additional purpose or functionality other than solely being a combined medium of exchange, unit of account, and store of value, including without limitation units of value that have the purpose of storing information in addition to, or other than, a measure of value, or function as a smart contract, network access, good, service, utility, application, or means of communication of information, in addition to, or other than, a measure of value.

Note on revisions:

- The replacement of "or" with "and" in the first (1) above, is made to ensure that any "digital representation of value" included within the definition of "virtual currency" is of the same nature as "money," which does not raise the constitutional concerns discussed above.

- The addition of the first (3) and (4) above, are made to ensure that any "digital representation of value" that includes information that could be deemed protected speech under the First Amendment, or an item of commerce under the Commerce Clause, or the subject matter of a contract under the Contract Clause, is excepted from the definition of "virtual currency," to avoid infringement of such rights.

Revisions to Definition of "Monetary Value":

"Monetary value": means a medium of exchange, whether or not redeemable in money, and includes virtual currency. "Monetary value" does not include digital representations of value that have:

(1) value derived from information inherent therein, other than a measure of value; or

(2) an additional purpose or functionality other than solely being a combined medium of exchange, unit of account, and store of value, including without limitation units of value that have the purpose of storing information in addition to, or other than, a measure of value, or function as a smart contract, network access, good, service, utility, application, or means of communication of information, in addition to, or other than, a measure of value.

Note on revisions:

- The addition of (1) and (2) above, are made to ensure that any "digital representation of value" that includes information that could be deemed protected speech under the First Amendment, or an item of commerce under the Commerce Clause, or the subject matter of a contract under the Contract Clause, is excepted from the definition of "virtual currency," to avoid infringement of such rights.

Revisions to Definition of "Money Transmission":

"Money transmission" means to engage in the business of:

(1) Selling or issuing payment instruments; or

(2) Receiving money or monetary value for transmission, transfer, exchange, or delivery to a location within or outside the United States by any and all means, including wire, internet, facsimile, or electronic transfer.

Money transmission does not apply to courier services.

Money transmission does not apply to a decentralized exchange, application or blockchain network. As used herein "decentralized" shall mean that no one person or minority group maintains control of the exchange, application or blockchain network.

Money transmission does not include:

(1) the sole provision of internet connection services, telecommunications services, or network access;

(2) the transmission, transfer, exchange, or delivery of a virtual currency by a:

(i) blockchain technology company, creator, developer, broker, dealer, asset manager, sales agent, offeror or seller in connection with an initial coin, token or asset public offering or sale;

(ii) person, on behalf of such person or such person's family member, spouse, partner, shareholder, member or beneficiary, for any lawful purpose, including but not limited to investing, buying or selling, or receiving virtual currency as payment for the purchase or sale of goods or services; or

(iii) decentralized exchange, application or blockchain network. As used herein "decentralized" shall mean that no one person or minority group maintains control of the exchange, application or blockchain network.

Note on revisions:

- The first addition above, as to the inapplicability to decentralized exchanges, application and blockchain networks, was made to ensure the growth of decentralized blockchain technology is nurtured, while acknowledging that such decentralized items cannot effectively be regulated, since there is no responsible party or group.

- The addition of (2) above, was made to provide absolute clarity to individuals using blockchain technology (including but not limited to cryptocurrecnies) and the blockchain industry as a whole, that the State of Hawaii will not regulate the creation and launching of new blockchain technology under Chapter 489D, or the personal use of blockchain technology or decentralization; thereby encouraging investment capital to flow into the State of Hawaii and reducing the likelihood of challenges to the Amendment. It is the proponents of the blockchain industry that would be the first to attack the Amendment on grounds of constitutional infringement and for being overbroad. By excepting these limited

activities from "money transmission" we hope to avoid the otherwise likely challenges to the Amendment.

The IBRA is not of the opinion that the foregoing revisions eliminate infringement of the U.S. Constitution or the general principles of a democratic society. Such revisions are only offered to help minimize potential challenges, if the State of Hawaii insists on regulating "virtual currency" under Chapter 489D.

Alternative Legislation

If the State of Hawaii wants to take some form of regulatory action, but is uncertain as to what would be most appropriate at this time, it should consider passing on the Act and Amendment and introducing legislation similar to that enacted by the State of Wyoming, addressing concerns over the security status of digital tokens (cryptocurrencies), which create a barrier to the flow of investment capital through states such as the State of Hawaii who have not clarified the standing of digital tokens (cryptocurrencies).

In addition, the State of Hawaii should consider enacting an original act focused on the regulation of virtual currency exchanges, as opposed to trying to regulate such exchanges through Chapter 489D. This would enable the State of Hawaii to invite legitimate virtual currency exchanges to the state, to transact virtual currency transactions with the public. Any progress the Act or Amendment may have made toward this end will be buried under the litigation that would ensure if the Act or Amendment were enacted. A simple virtual currency exchange act could resolve the current barriers to entry created by Chapter 489D without degrading the validity of Chapter 489D by expanding its application beyond its traditional reach. The same outcome can be achieved without creating the extensive array of legal issues. The IBRA is in the process of drafting a proposed virtual currency exchange act that will address the issues raised in this memorandum towards the end of providing a valid and enforceable act to achieve the State of Hawaii's goal of curtailing criminal activity and protecting the public interest.

Conclusion

H.B. 2257, S.B. 2129 and S.B. 3082 are admirable first attempts by the State of Hawaii at regulating virtual currencies, in effort to regulate Bitcoin and other cryptocurrencies. However, such bills fail to set forth enforceable statutory frameworks that have meaningful application. The use of definitions that have extensive breadth result in the bills not being narrowly tailored to promote a significant government interest. At a minimum, this invites constitutional challenges under the Commerce Clause, Contract Clause, First Amendment, and the general principles of a democratic society.

This is particularly concerning since the State of Hawaii's governmental interests of curtailing criminal activity, preserving confidence in the financial system, and protecting the public interest, is already being promoted by the existing regulatory framework applicable to virtual currencies, including without limit: Chapter 708A – Money Laundering, Hawaii Revised Statutes; Chapter 485A – Uniform Securities Act, Hawaii Revised Statutes; Chapter 481A – Uniform Deceptive Trade Practice Act, Hawaii Revised Statutes; U.S. Securities Act 1933; U.S.

Securities Exchange Act 1934; U.S. Commodities Exchange Act; Sherman Act and U.S. Federal Trade Commission Act of 1914.

The State of Hawaii should not approve H.B. 2257, S.B. 2129 or S.B. 3082, and instead should rely upon existing regulations to promote its government interest, and should monitor the growth and integration of blockchain technology while becoming educated as to the nature of blockchain technology and the potential uses, benefits and challenges it will provide as society moves forward into the digital information age. At the same time, the State of Hawaii should consider enacting legislation substantially similar to that enacted by the State of Wyoming regarding cryptocurrencies, and an act focused solely on the regulation of virtual currency exchanges. In the event the State of Hawaii chooses to abandon H.B. 2257, S.B. 2129 or S.B. 3082, the IBRA will provide proposed legislation to the State of Hawaii, substantially similar to that enacted by the State of Wyoming, and an act focused solely on the regulation of virtual currency exchanges (namely, the Cryptocurrency Custodial Wallet & Exchange Act created by the IBRA using section 489D as a model).

In the event, the State of Hawaii deems it necessary to approved one of the existing bills, at this time, the IBRA recommends the State of Hawaii only approve Part II of H.B. 2257 and S.B 3082, with the revisions set forth herein above. Although this will not fully address the deficiencies in such bills, it will greatly reduce the likelihood of constitutional challenges, and therefore increase the likelihood of an enforceable regulatory framework, albeit one that may not achieve all the desired results due to the need to recognize the constitutional rights of the people.

We are confident the State of Hawaii will see the need to reconsider the regulatory approach it is currently taking and correct course to introduce legislation that not only serves its interests of curtailing criminal activity, preserving confidence in the financial system, and protecting the public interest, but also preserves the rights that are essential to a democratic people. The IBRA offers itself as a servant of the people, to assist the State of Hawaii in any way it requests moving forward towards our mutual goal of enacting effective regulation of the blockchain industry.

Sincerely,

Ian P. Luthringer

Ian P. Luthringer, J.D.

TESTIMONY OF THE
COMMISSION TO PROMOTE UNIFORM LEGISLATION

ON S.B. NO. 3082, S.D. 1
RELATING TO VIRTUAL CURRENCY.

BEFORE THE HOUSE COMMITTEE on INTRASTATE COMMERCE

DATE: Wednesday, March 14, 2018, at 9:00 a.m.
Conference Room 429, State Capitol

PERSON(S) TESTIFYING: KEN TAKAYAMA or PETER HAMASAKI
Commission to Promote Uniform Legislation

Chair Ohno and the members of the House Committee on Intrastate Commerce:

My name is Ken Takayama, and I am a member of the state Commission to Promote Uniform Legislation. Thank you for the opportunity to testify on this measure, S. B. No. 3082, S.D.1 Relating to Virtual Currency. The members of our state commission are Hawaii's representatives on the national Uniform Law Commission, or ULC. The ULC is a nonprofit organization that is made up of volunteer attorneys appointed by their states, and its mission is to develop and draft model legislation for states in areas in which uniformity is practical and desirable. The state Commission to Promote Uniform Legislation submits the following comments:

1. This measure seeks to regulate virtual currency businesses through the State's money transmitter statute.

2. We believe that Part I of H.B. No. 2257, H.D.1, passed by this Committee on January 31, 2018, which enacts the Uniform Regulation of Virtual Currency Businesses Act (URVCBA), provides a superior approach to the regulation of virtual currency businesses

3. S.B. No. 3082, S.D.1 attempts to stretch a law focused upon the transmission of money and legal tender to regulate virtual currencies which are not legal tender and not necessarily being transmitted..

4. By comparison, the URVCBA creates a clear, comprehensive framework for regulating companies engaged in virtual-currency business activity. “Virtual-currency business activity” means exchanging, transferring, or storing virtual currency; holding electronic precious metals or certificates of electronic precious metals; or exchanging digital representations of value within online games for virtual currency or legal tender.

5. Regulation of virtual currency businesses through the money transmitter law as proposed in this measure increases the risk of over inclusive regulation, potentially covering individuals merely using virtual currency to make purchases on their own behalf, or academics researching, for example, virtual currency, and encryption technology and security. The URVCBA provides for exemptions for among other things, personal, family and academic uses, certain online games and certain merchant rewards programs. The URVCBA prevents these uses of virtual currency, which pose no risk of potential loss or harm to consumers, from being swept into the regulatory scheme.

6. The uniform act creates a three-tiered regulatory structure. Persons in Tier 3, whose virtual currency business activity exceeds $35,000 in a one year period cannot operate in the State unless they obtain a license from the Division of Financial Institutions (DFI) of the Department of Commerce and Consumer Affairs. Tier 2 consists of providers with virtual-currency business activity levels between $5,000 and $35,000 annually, who are required to register with the DFI—which is a lighter regulatory burden than licensure. By comparison, Tier one exempts from regulation altogether those persons having virtual-currency business activity levels of under $5,000 a year. Taken together, the three tiered regulatory structure that correlates higher levels of virtual currency business activity with stricter levels of regulation functions as a “regulatory on-ramp,” that

allows companies in their early stages of business development to focus on innovation and experimentation while they are in the earliest stages of development--where they would normally face the greatest threat from the imposition of regulatory burdens.

7. The uniform act is also designed to protect consumers and their virtual currency. For example, section -51 of the URVCBA requires licensees and provisional registrants to issue disclosures to potential customers to inform them about fees, any insurance coverage for the product or service, etc. In addition, all virtual-currency businesses regulated by the Act must establish specific policies and compliance programs to guard against fraud, cyberthreats, money-laundering, and terrorist activity.

8. For the foregoing reasons, we respectfully request that this committee amend S.B. No. 3082, S.D.1 so that its contents are identical to those of H.B. No. 2257, H.D.1 as passed by this committee on January 31, 2018. The primary change would be to add the contents of the Uniform Regulation of Virtual Currency Businesses Act as Part I of this bill, and designate sections 1 to 9 of the measure as Part II.

Thank you very much for this opportunity to testify.

SB-3082-SD-1
Submitted on: 3/12/2018 4:30:49 PM
Testimony for IAC on 3/14/2018 9:00:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Todd Hoch	Individual	Comments	No

Comments:

Aloha Senators and committee members,

My name is Todd Hoch and I am the owner of a Hawaii based company called Blockchain Investments, LLC. I invest in private equity for blockchain focused companies; private and pre-sale ICO's (intital coin offerings) and trade crypto currencies.

As you have heard testimony already, blockchain technology is very new and dynamic. Unfortunately, this makes regulating blockchain extremely difficult since it's uses, applications, properties and classification does not conveniently fit into just one category. That being said, let me offer a few comments:

I am generally in favor of SB3082. I believe the spirit of the law is to redefine permissible investments so that exchanges such as Coinbase will re-enter the Hawaii market. In addition, it provides additional consumer disclosure regarding some of the risks in buying, holding and trading crypto currencies. This I view as positive.

Access to crypt currency is the starting point for any invdividual, business owner, entrepreneur or investor. My lack for full support to SB3082 is in the vagueness of the language. For example, as I read the bill it does not provide protection to the individual who simply buys or sells a very nominal amount to a family member or friend. Nor does the bill protect investors like me who buy, sell and trade crypto currencies in my individual portfolio. **My suggestion is to amend SB 3082 and follow the New Hamshire law by including language that exempts individuals, investors and traders who transact nominal amounts of crypto currency for non-business purposes under the money transmitter licensing rules.**

I believe that a light touch regulatory approach is the ideal solution for Hawaii. SB3082 with the amended language I suggest will provide the best outcome to the residents of Hawaii. It will provide the greatest impact on fostering innovation, financial inclusion and economic prosperity.

In conclusion, Hawaii must support technology that can bring environmentally friendly and high paying development jobs to our State. In fact, we tried to encourgage and incentivize new technologies through Act 221. I believe blockchain technology is ideal

for Hawaii. The economic opportunities are enourmous! A light touch approach at this stage in the advancement of the technology is the appropriate regulatory approach. That is why I am generally in favor of SB3082 and apposed to HB2257 and SB2129.

Respectfully submitted,

Todd Hoch

CEO Blockchain Investments, LLC

LATE LATE

SB-3082-SD-1
Submitted on: 3/14/2018 4:27:13 AM
Testimony for IAC on 3/14/2018 9:00:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Spencer Toyama	Individual	Oppose	Yes

Comments:

I strongly oppose this measure. My name is Spencer Toyama, and am a kamaʻaina technology entrepreneur based in Hawaiʻi. I co-founded Sudokrew (we built Island Pulse, which many of you may be familiar with), and began this business with the objective to provide new technology jobs with modern technology around the values of Hawaiʻi (sustainability, compassion, and education). We develop technology on the blockchain as part of our service offerrings and receive many job inquiries specifically because we work with blockchain technology (not to be confused with cryptocurrency trading) and other modern web technologies. We are creating the jobs that the current generation of young people are interested in taking.

This bill and the accompanying HB2257 would centralize control of any cryptocurrency to the State government, and require unnecessary barriers to entry in order to hold or exchange cryptocurrencies. These measures would create a monopoly for large exchanges such as Coinbase or Binance, and make it unreasonably difficult for startups pursuing new businesses based on the blockchain or other distributed technologies that reach beyond trade. From my understanding of these measures, it is attempting to protect consumers from cryptocurrency schemes, and is willing to sacrifice any new technology innovations, entrepreneurship opportunities, and future jobs in order to do so.

The bill itself does little for consumer protection, as most of the cryptocurrency schemes can be executed without detection from any government, and will ensure that entrepreneurs like myself have limited opportunities to work on this technology legally. Consumer protection should take place, however the crime itself (pyramid schemes like Bitconnect follow the exact same structure as Lularoe and Amway) should be regulated as opposed to the technology that is being used. This measure would be similar to forcing internet entrepreneurs to work through AOL if they wanted a domain hosted, but only if you're from Hawaiʻi, because Hawaiʻi residents were being taken advantage of by Somalian email schemes or people were making unwise investment decisions during the first internet boom in the earlly 2000ʻs.

As a tech entrepreneur based in Hawaiʻi, Iʻve seen most of my friends leave this island in search of new opportunity, and many have directly cited Hawaiʻiʻs over-regulation of cryptocurrencies as a reason for leaving. The main reason people leave is because they

don‘t see a future in Hawai‘i, and these measures make any hope of having a technology job in Hawai‘i very bleak.

If the state wishes to protect residents from risky investments, consider adjusting regulations for accredited investors and net worth calculations to apply to cryptocurrency investments and holding. If the state is looking to protect citizens from pyramid schemes, consider enforcing consumer protection laws around pyramid schemes. If the state wishes to create new opportunities for entrepreneurs, please consider reversing the current regulation around cryptocurrencies to allow for equitable trading and business opportunities with the rest of the global community.

LATE LATE

SB-3082-SD-1
Submitted on: 3/13/2018 9:29:55 PM
Testimony for IAC on 3/14/2018 9:00:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Forest Frizzell	Individual	Oppose	No

Comments:

I believe it would be short-sighted to make Coinbase or any other cryptocurrency wallet a monopoly in Hawai‘i. Additionally requiring a commissioner to deem a crypto holder a money transmitter that needs to be registered with the state would adversely affect the ability to participate in the cryptocurrency market. There are simply too many diverse options, for diverse investors to be held to a single technology.

LATE

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BLOCKWEATHER HOLDINGS, LLC

TO THE HOUSE COMMITTEE ON INTRASTATE COMMERCE

TWENTY-NINTH LEGISLATURE
REGULAR SESSION OF 2018

Wednesday, March 14, 2018
9:00 AM

TESTIMONY ON S.B. NO. 3082, S.D. 1, RELATING TO VIRTUAL CURRENCY

TO THE HONORABLE TAKASHI OHNO, CHAIR, AND MEMBERS OF THE COMMITTEE:

I am Dr. David Henry, the Managing Partner of Blockweather Holdings, LLC ("Blockweather"), one of the first and a leading virtual currency investment firm. Blockweather has emerged as a responsible, ethical, transparent, trusted source by which independent investors can gain access to the booming virtual currency industry. 2017 saw the global virtual currency industry grow by over 3,200% from $18.3 billion to $612.9 billion! 2018 and beyond will have tremendous opportunities for profitable investment as well, however it will take more skill, as large institutional investment firms have entered the market.

We all have the same goals, as follows:

1. Safe investment opportunities for the people of Hawaii

2. Legal and reliable opportunities by which the people of Hawaii, if they choose to do so, can invest in virtual currencies, as there are outstanding opportunities for profit

3. Good jobs in finance in Hawaii

4. Stimulation of economic growth in Hawaii

5. Creation of a business-friendly environment – good for Hawaii's people and economy

In 2016, a new Hawaii law caused Coinbase, one of the largest virtual currency exchanges in the world, to stop doing business with all Hawaii customers. This had the following effects, contrary to the common goals listed above:

111 Hekili Street, Suite A481, Kailua, HI 96734
8 The Green, Suite 6338, Dover, Delaware 19901
(844) 644-6837 | info@blockweather.com | blockweather.com

1. Removal of one of the most reliable sources for virtual currency investment for the people of Hawaii

2. Potential reduction in future finance jobs in Hawaii

3. Stifling of the growth of blockchain technology-related businesses in Hawaii

4. Continuation of what is reported to be one of the most hostile business environments in the country

As a result, the people of Hawaii closed their Coinbase accounts. They either did not invest further in cryptocurrencies and missed out on **hundreds of percent returns,** or some sought out less reputable companies for investment. Of the Hawaii clients who invested with Blockweather, they saw outstanding returns and excellent customer service. One Blockweather client in Hawaii saw such returns within three months that she was able to pay off her daughter's education. Another client bought a car. Another received $25,000 in profits to compensate for losses he sustained through another venture, and he can now buy a condo in Hawaii. Blockweather has done good things for the people, jobs, and economy of Hawaii. The proposed bill will drive good business and economic growth away.

The present bill, S.B. No. 3082, S.D. 1, as well as H.B. 2257, H.D. 2, aim to increase regulation of the virtual currency industry and impose similar regulations as are on traditional money transmitters. I support the goal of providing safe investment opportunities in Hawaii. However, S.B. 3082 and H.B. 2257 will have adverse effects on the people, investment opportunities, job opportunities, and economy of Hawaii, as did the previous legislation in 2016. The reasons I oppose these bills are as follows:

1. They will continue to drive away blockchain technology and virtual currency companies from doing business in and providing desired services to the people of Hawaii. The people of Hawaii, your constituents, want this technology and these services.

2. They will significantly reduce the number of finance- and technology-related jobs in Hawaii. My company alone has created several excellent hedge fund jobs in Hawaii. If your son or daughter majors in finance in college, they will likely have to live on the mainland to find work, as there are relatively few finance jobs in Hawaii.

3. The virtual currency industry is complex and developing. In discussions with legislators, they report a very limited understanding of the virtual currency industry that they are voting to stifle

in Hawaii. **A more complete understanding of the virtual currency industry and the vast benefits and uses of blockchain technology – which will develop as the industry progresses – is needed to allow legislators to make informed decisions.**

4. From a feasibility standpoint, traditional money transmitters have available software and platforms that have been developed and perfected over many decades and allow them to comply with the Money Transmitters Act and the proposed legislation. The virtual currency industry is relatively new. Middle- and back-end software, investment management platforms, and security auditing capabilities are only now being developed for virtual currency companies. Most virtual currency hedge funds have been open for less than a year. The nacency of the industry and **limitations of available software and platforms** make it practically very difficult for new companies to comply with the proposed legislation.

Most importantly, the proposed legislation will be bad for the people, economy, business environment, technological development, and job opportunities in Hawaii. In contrast, Delaware and other business- and virtual currency-friendly states have attracted business, investment, and jobs and have been thriving. Nearly no other states have in effect the legislation that is proposed here in Hawaii. Please see **Wyoming House Bill H.B. 0019 –** signed into law on March 6, 2017 – which provides an *exemption* for virtual currency from the Wyoming Money Transmitter Act.

It should also be noted that laws related to fraud, theft, computer security, contracts, negligence, and anti-money laundering already apply to virtual currency companies in Hawaii, helping to prevent wrongdoing.

In the future, as the industry matures, specific laws may be reconsidered. However, additional education and more sophisticated software and platforms are needed. The proposed legislation will limit jobs, business and investment opportunities in Hawaii.

THEREFORE, I strongly oppose S.B. 3082 and H.B. 2257. Thank you for your time.

Respectfully,

David Henry

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Aloha,

I am testifying as a private citizen in support of SB3082.

In the interest of full disclosure, I was the Insurance Commissioner of the State of Hawaii from 2003-2010, I am currently an advisor to the Ethereum Foundation and have given presentations on insurance regulation of blockchain at the #D1Conf on decentralized insurance and the Government of Mexico's XXVII International Seminar on Securities and Finance.

Ethereum is the second largest virtual currency enterprise behind Bitcoin with a market cap of around $80 billion. I am not testifying on behalf of Ethereum. These are my own private opinions.

Currently, citizens of 49 states can exchange and trade virtual currency of a recognized Exchange. Because of an interpretation of Hawaii's Money Transmitter Law, there are no legitimate exchanges in Hawaii. Therefore, it is critical that Hawaii's law be amended to allow legitimate Exchanges to operate as they do in all other states.

The legitimization of virtual currency trades and exchange is extremely Important, not just to provide Hawaii citizens with another investment vehicle, but because virtual currencies are essential to the operation of Distributed Ledger Technology (DLT) also known as blockchain.

The World Economic Forum, Deloitte, McKinsey and other reputable business analysts have said that DLT will be as transformative of society as the internet.

"This is a very big deal. It's so much more dramatic than [when the internet was launched]," says Eric Sweden, NASCIO's program director for enterprise architecture and governance. "It's going to have a huge impact on how we do business, accounting, auditing -- anything that has a data lineage to it." National Association of State Chief Information Officers

"In a digital world, the way we regulate and maintain administrative control has to change." Harvard Business Review

An alternative is to simply exempt virtual currency from the money transmitter law. Wyoming just enacted such an exemption. Many states and nations have decided to step back and not enact new regulations that might stifle innovation in this area. They recognize that the tremendous benefits of blockchain technology must be given some space to develop.

The heads of the SEC and Commodity and Futures Trading Commission recently testified before Congress that their approach to regulation in this new area is "first, do no harm". Nevertheless, they are pursuing those engaged in fraud or violation of current security laws thus providing protection to consumers. Hawaii also has laws to protect citizens from fraud.

Exempting virtual currency would send a signal that Hawaii welcomes and wants to participate in this new technology. Major corporations around the world are working together in consortia to develop applications for blockchain in their business. Enterprise Ethereum Alliance has over 200 members, including JP Morgan, British Petroleum, Mastercard, Intel, Microsoft, Earnst and Young, Royal Bank of Canada, BNY Mellon, Credit Suisse, Deloitte, Ing, Pfizer, and UBS. Leaders in the Transportation industry, the Healthcare industry, Insurance, as well as the financial industry are working on blockchain applications to improve their industries. The World Economic Forum issued a report entitled "The Future of

Financial Infrastructure" providing a good view of the benefits of blockchain for several industries.

It is critical that Hawaii take this first step to participate in this new technology for the benefits and economic development that this technology supports.

If you have any questions, please do not hesitate to contact me.

J. P. Schmidt
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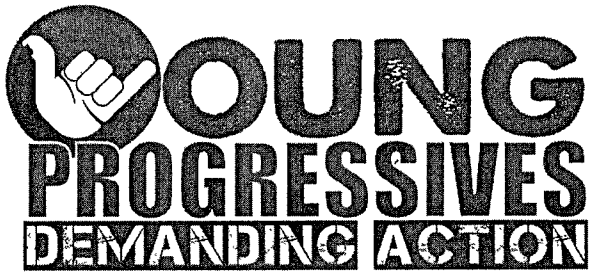

Aloha Chair Ohno, Vice Chair Choy, and Members of the Committee,

I am testifying in opposition to SB 3082 as this bill is currently written. I writing on behalf of the next generation young people that is poised to leave Hawaii to see job opportunities on the mainland. Far too many of my high school classmate, UH Manoa College of Engineering classmates, and siblings now living on the mainland to work in the tech industry. If SB 3082 passes as written, we are sending more young people who want to work in the tech industry directly to the mainland.

We understand that the intent of this bill is to allow cryptocurrency exchanges to return to Hawaii by amending the money transmitters statute to allow electronic tokens to be counted as reserve currencies. We fully support this part of the measure, however, we take issue with the overly broad classifications of folks who exchange cryptocurrencies as money transmitters.

We understand that there are concerns about scams and fraud associated with this industry but we feel there are better ways to address these concerns WITHOUT the money transmitter classification. The CFTC and SEC are in the process of writing rules that will regulate cryptocurrency exchanges therefore regulation at the state level would be unnecessary. To regulate pyramid schemes or other sorts of scams, specific language to address such practices as they relate to this industry could be drafted.

We suggest two alternative models:

1) Deregulate this industry and classify cryptocurrencies as exempt from the money transmitters statutes. Please see attached Wyoming Bill HB 19.
2) Voluntary Licensing paid for by the industry. Members of the entrepreneurial community want to demonstrate to the public that they are trustworthy entities and are willing to pay for the cost of DCCA staff. By having voluntary licensing we will allow those who want to causally engage in this industry by buying electronic tokens as personal investments, or allowing new startups to test technology, a voluntary program would allow such entrepreneurs to operate. I have spoken to several established companies that would be willing to pay and support such a program. In addition, the industry would advertise to the public and would help promote the message to the public to only buy from certified industry professionals.

Thank you for allowing me to testify.
Cameron Sato - Young Progressives Demanding Action