Senate FIEDT Committee
Licensing and Regulation of Digital Assets
December 1, 2020

Washington State Department of Financial Institutions

"Leading the way in consumer protection and financial services regulation ."

Securities and Initial Coin Offerings
Bill Beatty, Director of Securities

It is unlawful to offer or sell a security unless:

- **The security is registered or exempt;**
- **The persons selling the security are licensed or exempt; and**
- **There is full disclosure of all material facts to all offerees and purchasers.**

What is a “security”?

- **Stocks**
- **Bonds**
- **Notes**
- **Mutual Funds**
- **Investment Contract**

Investment Contract

***Howey* test:**

- ***Investment of money,***
- ***In a common enterprise,***
- ***With a reasonable expectation of profits to be derived from the efforts of others.***

***SEC v. W.J. Howey Co.*,328 U.S. 293 (1946)**

Howey continued

- **Substance over form. Applies to any contract, transaction or scheme even if not a typical security.**
- **Focus not only the instrument itself, but also on the manner in which it is offered and sold.**

Initial Coin Offerings (ICOs)

- **Tokens or coins are sold to develop networks on which digital assets will operate.**
- **Purchasers are told that once the network is built, the enterprise will be more valuable and they can sell their coins or tokens at a profit.**

Regulatory Guidance

- **The *DAO Report,* SEC Release No. 34-81207, July 25, 2017**
- ***Digital Asset Transactions: When Howey Met Gary (Plastic).* Speech by William Hinman, SEC Director of Corporation Finance, June 14, 2018**
- ***Framework for "investment Contract" Analysis of Digital Assets*, SEC Staff, April 3, 2019**

Virtual Currency Regulation
Cindy Fazio, Director of Consumer Services

Interim Guidance – 12/8/2014

- Defined virtual currency
- Required licensure for exchange or wallet holding services
- Set minimum tangible net worth for custodial wallet holders
- Required a third party security audit for custodial wallet holders

Interim Guidance, Continued

- **Required licensees transmitting virtual currency to hold virtual currency of the same type and value as that held by the licensee but obligated to consumers.**

Definition

"Virtual currency" means a digital representation of value used as a medium of exchange, a unit of account, or a store of value, but does not have legal tender status as recognized by the United States government.

Definition

"Money transmission" means receiving money or its equivalent value (equivalent value includes virtual currency) to transmit, deliver, or instruct to be delivered to another location, inside or outside the United States, by any means including but not limited to by wire, facsimile, or electronic transfer.

History of CS Regulation

SSB 5031 Uniform Money Services --Virtual Currency—Online Currency Exchangers (Mullet)

Chapter 30, Laws of 2017, Effective 7/23/17

- **Followed the guidance**
- **Added consumer disclosures**

History of CS Regulation

Amendment to the Rules –
Chapter 208-690 WAC

Effective 8/1/18

Business Model Examples

Bitcoin ATM – consumer inserts cash into kiosk and receives a paper wallet which is the value of the bitcoin purchased OR vice versa

3rd party money transmitter – consumer A gives licensee fiat or virtual currency for transmittal to consumer B.

Business Model Examples

Service provider to merchants – consumers purchase goods and services with bitcoin. Licensee exchanges bitcoin for fiat and remits fiat to merchant.

Wallet provider with control stores virtual currency for consumer. Control - Licensee has access to value and controls its movement.

Not Regulated

Users – persons who use virtual currency for their own use

Wallet provider that stores virtual currency but does not have access to the value or unilateral power to execute a transaction

- **Multi-sig wallet models**

Not Regulated

Data storage or security services not otherwise engaged in virtual currency business activity on behalf of other persons

Providers of software or protocols governing the transfer of the digital representation of value

- **Software or hardware provider helping miners mine bitcoins**

Not Regulated

Verification of ownership or authenticity through a virtual distributed ledger system when the virtual currency is not used as a medium of exchange

- **Registration of documents, property, etc. without use of notaries**

Crypto Asset Custody
Roberta Hollinshead

- **Crypto Asset Custody – Emerging issue and regulatory response**

- **Wyoming Special Purpose Depository Institution – New Commercial Bank Charter**

Crypto Asset Custody, Continued

Trust Charter for Crypto Asset Custody

SB 5107 Addressing Trust Institutions (Das)
Chapter 389, Laws of 2019