



ILLINOIS DEPARTMENT OF FINANCIAL AND PROFESSIONAL
REGULATION

DIGITAL CURRENCY REGULATORY GUIDANCE

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Purpose

Digital currencies such as Bitcoin, Dogecoin, Ethereum, Litecoin, and ZCash have raised questions with respect to money transmission and exchange of currency. This guidance outlines the policy of the Illinois Department of Financial and Professional Regulation (the “Department”) with regards to digital currencies. This guidance expresses the Department's interpretation of Illinois’ Transmitters of Money Act¹ (“TOMA”) and its application to various activities involving digital currencies. This guidance seeks to establish the regulatory treatment of digital currencies under TOMA as it currently exists.

Characteristics of Digital Currency

In short, a digital currency is an electronic medium of exchange used to purchase goods and services. A digital currency may also be exchanged for money.² A digital currency, by nature of its properties detailed below, is distinct from money.

Legal Tender vs. Non-Legal Tender:

As of the date of this regulatory guidance, the Department is not aware of any jurisdiction in which digital currency has status as legal tender or of any digital currency issued by a government’s central bank. As such, digital currencies exist outside the recognition of established financial institutions.

Centralized vs. Decentralized:

There are generally two basic types of digital currencies: *centralized* and *decentralized*. ***Centralized digital currencies*** are created and issued by a specified source. They rely on a person or entity with authority or control over the currency. Typically, the person or entity exercising authority or control over the centralized digital currency is also the creator of that currency.

In addition to the two types of centralized digital currency, there are numerous sub-classifications. Centralized digital currencies can be *non-convertible* meaning they can be purchased with money, but cannot be exchanged back to money. Centralized digital currencies can also be *convertible* meaning they can be converted back to money. Additionally, some centralized digital currencies can be used only for purchase of goods and services from a closed

¹ Illinois Compiled Statutes (205 ILCS 657/1, *et seq.*).

² In this guidance the term money will be used to mean government-issued currencies with legal tender status in the country of issuance.

universe of merchants, are specific to a particular virtual domain or world,³ or have a theoretically open universe of merchants.

Decentralized digital currencies are not created or issued by a particular person or entity, have no administrator, and have no central repository. Although decentralized digital currencies are not classified as a legal tender, they are convertible, meaning they have equivalent value in money and can be exchanged to or for money. Most, but not all, decentralized digital currencies are also cryptocurrencies. These include Bitcoin, Litecoin, Peercoin, Namecoin, Ether, etc. A cryptocurrency is based on a cryptographic protocol that manages the creation of new units of the currency on a shared ledger through a peer-to-peer network. Cryptocurrency is often created through a process called mining performed by the “miner.” Mining involves running an application on a computer that performs consensus algorithm calculations called proof-work. When the computer performs a sufficient amount of these calculations, the cryptocurrency's underlying protocol generates a new unit of the currency which can be delivered to the miner's wallet. Because users' wallets act as the connection points of the digital currency's decentralized peer-to-peer network, transfers of digital currency are made directly from wallet to wallet, whereas transmissions of money must be made through one or more intermediaries such as a financial institution or money transmitter.

One differentiating characteristic of decentralized and centralized digital currency is that while centralized digital currency can have intrinsic value through backing by money or precious metals, decentralized currency lacks intrinsic value. A unit of decentralized digital currency does not represent a claim on a commodity, and is not convertible by law. Its value is only what a buyer is willing to pay for it.

Decentralized digital currencies are often traded on third party exchange sites for money or other digital currencies where the exchange rates are determined by averaging the transactions that occur. Decentralized digital currency can also be considered a new asset class that is neither currency nor commodity.

³ The term “virtual currency” commonly used by other governmental bodies can be used interchangeably with the term “digital currency” throughout this guidance document.

Application of Transmitters of Money Act

For clarity and consistency, this guidance is focused on money transmission activities involving digital currencies using the following definition of digital currency:

(A) digital representation of value that:

- (1) is used as a medium of exchange, unit of account, or store of value;***
and
(2) is not legal tender, whether denominated in legal tender; and

(B) does not include:

- (1) software or a protocol governing transfer of the digital representation of value;***
(2) a transaction in which a merchant grants value as part of an affinity or rewards program, which value cannot be taken from or exchanged with the merchant for cash or bank credit; or
(3) a digital representation of value used exclusively within an online game or game platform.⁴

This definition of digital currency excludes closed network loyalty and other points and/or game programs that are otherwise regulated within current statutory regimes. As such, businesses engaging in activities that may be considered money transmission involving closed network loyalty and other points and/or game programs schemes should seek an individual licensing determination from the Department.

Whether or not an Illinois money transmitter license is required for an entity to engage in the transmission of decentralized digital currencies turns on the question of whether digital currency is considered "money" as defined in TOMA. Accordingly, Section 5 of TOMA defines a "[m]oney transmitter" as:

[A] person who is located in or doing business in this State and who directly or through authorized sellers does any of the following in this State:

- 1) Sells or issues payment instruments***
- 2) Engages in the business of receiving money for transmission or transmitting money.***
- 3) Engages in the business of exchanging, for compensation, money of the United States Government or a foreign government to or from money of another government.***

⁴ Uniform Law Commission, *Draft Regulation of Virtual Currency Business Act*, April 14, 2017.

Furthermore, Section 5 of TOMA defines the action of “[t]ransmitting money” as:

[T]ransmission of money by any means, including transmissions to or from locations within the United States or to and from locations outside of the United States by payment instrument, facsimile or electronic transfer, or otherwise, and includes bill payment services.

Section 5 of TOMA defines “[m]oney” as:

[A] medium of exchange that is authorized or adopted by a domestic or foreign government as a part of its currency and that is customarily used and accepted as a medium of exchange in the country of issuance.

Accordingly, although digital currencies are a digital representation of value that is used as a medium of exchange, store of value, or unit of account, they are not considered money for the purposes of TOMA as digital currencies have not been “authorized or adopted by a domestic or foreign government as a part of its currency.” A person or entity engaged in the transmission of solely digital currencies, as defined, would not be required to obtain a TOMA license. However, should transmission of digital currencies involve money in a transaction, that transaction may be considered money transmission depending on how the transaction is organized. Any person or entity engaging in a transaction involving both digital currencies and money should request a determination from the Department on whether or not such activity will require a TOMA license.

Regulatory Treatment of Digital Currencies:

In order to provide further guidance and clarity on the application of digital currencies to TOMA, listed below are some examples of common types of digital currency transactions. Please note this is a non-exhaustive list.

Activities Generally Qualifying as Money Transmission

- Exchange involving both digital currency and money through a third party exchanger is generally considered to be money transmission. For example, some digital currency exchange sites facilitate exchanges by acting as an escrow-like intermediary. In a typical transaction, the buyer of digital currency sends money to the exchanger who holds the funds until it determines that the terms of the sale have been satisfied before transmitting the funds to the seller. Irrespective of its handling of the digital currency, the exchanger conducts money transmission by receiving the buyer's money in exchange for a promise to make it available to the seller.
- Exchange of digital currency for money through an automated machine is generally considered to be money transmission. For example, several companies have begun selling automated machines commonly called "Bitcoin ATMs" that facilitate contemporaneous exchanges of digital currency for money. 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 digital currency through a machine configured this way, the operator of the machine receives the buyer's money and is engaging in the "business of receiving money for transmission or transmitting money."

Some digital currency ATMs, however, 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 digital currency by the machine's operator directly with the customer, there is no money transmission because at no time is money received and neither party is engaging in the "business of receiving money for transmission or transmitting money."

Activities Not Qualifying as Money Transmission

- Exchange of digital currency for money directly between two parties does not qualify as money transmission. This is essentially a sale of goods between two parties. The seller gives units of digital currency to the buyer, who pays the seller directly with money. The seller does not receive money with the intent to transmit it to another entity or "engage in the business of exchanging, for compensation, money of the United States Government or a foreign government to or from money of another government."

- Transfer of digital currency by itself is not transmitting money. Because digital currency is not money, the receipt of it with the intent to transmit it to another entity is not “transmitting money.” This includes intermediaries who receive digital currency for transfer to a third party, and entities who, akin to depositories (commonly referred to as wallets), hold digital currency on behalf of customers and can either unilaterally execute or prevent a digital currency transaction.
- Exchange of one digital currency for another digital currency is not money transmission.
- A merchant who accepts digital currency as payment for goods or services or an individual who pays for goods or services with digital currency are commonly referred to as “users” of digital currency. Regardless of how many parties are involved, no money is involved at any point in this transaction, so “transmitting money” does not occur.
- Miners do not receive money for verifying transactions. Instead, Miners receive digital currency as payment for verifying transactions, typically by contributing software, connectivity, or computing power to process transactions. Because money is not involved in the payment of this work, “transmitting money” does not occur.
- Multi-signature software allows users to distribute authority over his or her digital currency among multiple different actors. This software requires multiple actors to authorize a digital currency transaction before the transaction can be consummated. Specifically, a multi-signature provider holds one of two or more private keys needed to authorize transactions. Regardless of how many parties are involved, no money is involved at any point in this transaction, so “transmitting money” does not occur.
- Blockchain 2.0 technologies refer to the use of a digital currency’s decentralized or distributed ledger system for non-monetary purposes such as verifying ownership or authenticity in a digital capacity. This technology includes software innovations such as colored coins (i.e. coins that are marked specifically to represent a non-monetary asset), smart contracts (i.e. agreements implemented on a distributed ledger), and smart property (i.e. property that is titled using a decentralized distributed ledger). These uses for non-monetary purposes may use digital currency as a medium of exchange, but do not involve the exchange or transmission of money or the sale or issuance of a “payment instrument” and as a result “transmitting money” does not occur.

Permissible Investments:

Any entity engaged in money transmission must comply with the permissible investment requirements as stated, in part, in Section 50(a) of TOMA:

A licensee shall maintain at all times permissible investments that have an aggregate market value computed in accordance with generally accepted accounting principles of not less than the aggregate amount of all its outstanding payment instruments and other transfers, except to the extent the amount is reduced from permissible investments under its method of accounting. The permissible investments may be owned by the licensee and, the investments, in an amount equal to the outstanding payment instruments issued and sold in this State, even if commingled with other assets of the licensee, shall be deemed by operation of law to be held in trust for the benefit of the purchasers of the licensee's outstanding payment instruments in Illinois in the event of the bankruptcy or insolvency of the licensee.

Pursuant to Section 50(b) of TOMA, the Department has discretion to approve other types of permissible investments accepted for licensing determinations:

Notwithstanding any other provision of this Act, the Director, with respect to any particular licensee or all licensees, may approve other permissible investments or limit the extent to which any class of permissible investments, except for money and certificates of deposit, may be considered a permissible investment.

The Department understands dollar-denominated capital reserve requirements impose added burdens on digital currency companies and therefore will consider digital currency reserves as a form of permissible investment.

Net Worth

Any entity engaged in money transmission must comply with net worth requirements as stated in Section 20(a)(1) of TOMA:

That the applicant has and maintains the net worth specified in Column A, computed according to generally accepted accounting principles, corresponding to the number of locations in this State at which the applicant is conducting business or proposes to conduct business by itself and by any authorized sellers specified in Column B:

<i>Column A</i>	<i>Column B</i>
<i>\$35,000</i>	<i>1</i>
<i>50,000</i>	<i>2-3</i>
<i>100,000</i>	<i>4-5</i>
<i>150,000</i>	<i>6-9</i>
<i>200,000</i>	<i>10-14</i>
<i>300,000</i>	<i>15-19</i>
<i>400,000</i>	<i>20-24</i>
<i>500,000</i>	<i>25 or more</i>

The Department will consider digital currency that the applicant/licensee owns as a part of its net worth. It is important to note, however, that this digital currency **does not** include any digital currency held on behalf of others.

Third-Party Payment Processors

On July 29th, 2015 the Department issued [regulatory guidance \(“Guidance”\)](#) determining that “third-party payment processors” act as an agent for the merchant in accepting and processing funds and as such do not fall under the licensure requirements of the TOMA. Third-party payment processors are defined in the Guidance as:

Any third-party who acts as a payment processor by accepting and transferring a payment in connection with facilitating a purchase via an agreement with the seller of the goods or services. This definition does not include bill payment services as defined by TOMA and bill payment services will need to continue to gain licensure.

Digital currency entities that engage in money transmission as previously defined, but act solely as a payment processor that accepts and transfers payments in connection with facilitating a purchase via an agreement with the seller of goods or services, are not required to obtain a transmitters of money license with the Department.