



April 1, 2016

Re: ULC Draft Regulation of Virtual Currency Business Activity

Dear Sarah Jane Hughes, Members, and Observers of the Uniform Law Commission,

Ripple is a technology company focused on distributed payment technology. We believe such tools can enable a more efficient payment system, reduce friction between currencies, and broaden access to financial services.

A well-defined, coordinated regulatory framework is needed to realize such benefits. Ripple firmly believes that a uniform national standard is necessary to ensure innovation can occur safely, efficiently, and with regulatory certainty.

Ripple recognizes the Uniform Law Commission's leadership in creating a standard for the regulation of virtual currency business activity. To that end, we offer these comments to assist the ULC in drafting an act that will be widely adopted. In this letter, Ripple:

- 1. Urges a Narrow Focus on Addressing Consumer Risk**
- 2. Explains the Shift to Emerging Enterprise Use Cases**
- 3. Considers Regulatory Models Best Suited for New Technology**

Ripple appreciates the leadership and work of the ULC and requests that it take into consideration the views expressed in this letter. We believe they best balance innovation with the need for robust, efficient regulatory frameworks suited for today's technology.

We are thankful for the opportunity to provide these perspectives and are happy to address any questions.

Sincerely,

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Remain Focused on Consumer Protections

Continue the Historical Focus on Consumer Protection

The introduction of virtual currencies and distributed ledgers was a technological breakthrough. Bitcoin, the first and most well-known example of the technology, was developed as a consumer-facing alternative to government-issued (fiat) currency.

Consumers directly engage with Bitcoin and similar protocols, assuming the risk of holding a volatile currency with limited or no recourse in the event of a problem. This consumer-facing approach creates an array of consumer protection concerns which have appropriately been the focus of states' attention to date – including the ULC's initial efforts.

The focus on consumer protection follows the precedent set forth by the states' regulation of money transmitters, which is reflected in the ULC's own Uniform Money Services Act. ULC's rule and states' existing oversight of money transmitters is designed to protect consumers from risks such as unfair practices, deceptive disclosures and financial loss from the insolvency of the company.

We urge the ULC to continue its focus on consumer protection and define its act to address unmitigated consumer risks posed by these new technologies.

Narrowly Tailor the Scope and Application of the Rule on Consumer Risk

We urge the ULC to craft a narrowly defined rule that is focused on protecting consumers from otherwise unmitigated risks posed by virtual currencies. However, the ULC's proposed act currently defines "virtual currency" in broad terms. The act may subject a wide range of non-consumer business activity to regulatory requirements.

Adoption of the proposed act in its current form could potentially sweep within regulation many unintended use cases and restrict innovation that is unrelated to the ULC's focus on consumer protection. Ripple does not believe that the ULC intends such a consequence or such unprecedented departure from the existing state-level regulatory framework.

Ripple urges the ULC to narrowly tailor the scope and definition of the rule to the otherwise unmitigated consumer risks associated with virtual currency. In doing so, the final act would have a much more specific definition that clearly articulates its focus and applicability. Establishing bright line standards and concrete scope will ensure the act is not subject to broad interpretation, undermining the purpose of a standard.

It is a well accepted legal principle that laws and regulations should be narrowly tailored to achieve a specific objective so as not to interfere with other interests, in this case innovation. A narrowly defined rule will ensure the act does not restrain unrelated and otherwise positive innovation from taking root.

The obvious concern raised by this approach would be the apparent lack of regulation as innovation proceeds. However, this perceived problem can be remedied through amendments



to the final version of the act, through interpretative guidance as new use cases and models emerge, or through existing regulatory frameworks.

Regarding Money Laundering and Terrorist Financing Risks

These technologies may pose other risks aside from consumer protection, but it is our view that they are already addressed in other frameworks, particularly at the federal level. For instance, concerns have been raised about the risk of these technologies being used by bad actors for money laundering or terrorist financing purposes.

These are important concerns, which we take seriously. Yet, Ripple strongly feels that standards for anti-money laundering (AML) and counter-terrorist financing (CTF) should continue to be set at the federal level only. We urge the ULC to fully defer to federal standards and reporting requirements rather than construct an additional, potentially inconsistent and conflicting state-level regime.

Keeping AML and CTF requirements at the federal level ensures consistency and our country's ability to easily remain coordinated with international standards.



Blockchain and Emerging Enterprise Use Cases

From Consumer to Enterprise Models

History shows that most technology breakthroughs are followed by several iterations that search to find where and how the technology will best take root. This same pattern is evident in virtual currency and distributed ledgers.

Since ULC first began its drafting effort, virtual currencies and distributed ledgers have evolved from a consumer-facing model to an enterprise approach where traditional financial services firms leverage the tools for new products and improved services.

Ripple is one such enterprise solution. Over the past year, Ripple's model has evolved to focus on financial institutions. Ripple licenses products to financial institutions who use the solutions to facilitate real-time, cross-border payments on behalf of their customers.

Consumers have no interaction with the technology, just as they do not directly engage with other wholesale payment rails used by banks (e.g., international wires). Ripple's enterprise approach utilizes the benefits of the technology without creating new consumer risk.

The Existing Regulatory Frameworks for Enterprise Use Cases

Under the enterprise approach, banks utilize the technology within existing regulatory and consumer protection frameworks. The consumer risks that are unmitigated in the consumer-facing model are properly addressed under existing rules within the enterprise approach.

The consumer's interaction with its bank is the same regardless of whether the bank uses Ripple or existing rails for payments. The consumer protection rules in place at banks today remain unchanged and are effective for payments that a bank facilitates via Ripple.

Further, by providing software to banks, Ripple and other enterprise providers become subject to the Bank Service Company Act and the FFIEC's examination and guidance on the ["Supervision of Technology Service Providers."](#) The use of these technologies as payment systems or securities exchanges will also be subject to federal and/or international expectations for financial market infrastructure. The enterprise use of these technologies typically fit within well-founded regulatory frameworks.¹

The broad adoption of enterprise use cases has implications for monetary policy and global systemic risk. For these reasons, it is appropriate that central banks along with the Financial Stability Board are actively working to address these new technologies in a globally coordinated way.

¹ While the enterprise models typically fit within existing frameworks, there are some specific expectations within the frameworks that may need to be reconsidered as they do not properly address distributed payment technologies. These issues are being addressed through the appropriate regulator(s).



The International Monetary Fund seconded calls for this type of global coordination: “The establishment of international standards that take into account the specific features of [virtual currency and distributed financial technologies] may promote harmonization in regulation across jurisdictions, and facilitate cooperation and coordination across countries over questions such as the sharing of information and the investigation and prosecution of cross-border offenses.”²

As the current risks associated with the enterprise use cases are already being addressed and future risks are properly being considered at the international level, the ULC’s attention to enterprise use cases (commonly referred to as “blockchain”) may not be necessary at this time.

Non-Currency Uses of the Tools

Along with the evolution in models (from consumer to enterprise), there has also been an evolution in how the tools are used. Bitcoin and other virtual currencies were used primarily as a replacement for fiat currency. New solutions, including Ripple, are not designed to replace fiat currencies, rather enable existing currencies to be exchanged more efficiently.

While payments in Ripple are denominated in fiat currency, Ripple does have its own asset (XRP) that may be used by financial institutions for two operational purposes. First, financial institutions use XRP as a “postage stamp” for payments made on Ripple. In doing so, XRP serves as a security mechanism to stop a denial of service or cyberattack on the system. As a security feature, XRP ensures Ripple’s reliability and operational resiliency.

Second, financial institutions use XRP as a currency-bridging tool. Ripple is designed for payments utilizing fiat currency. Due to the large number of government currencies and counterparties, quoting the conversion between every possible currency pair can be burdensome and especially difficult when dealing with rarely traded currencies.

To make this process more efficient, financial institutions on Ripple can use XRP as a bridge, or common denominator, between fiat currencies. Used in this way, XRP maximizes currency liquidity and geographic reach of payments in an efficient way.

XRP’s unique use cases give it a different risk profile than a consumer tool like bitcoin or other virtual currencies. While the security mechanism and liquidity tool are alternative use cases that exist today, we believe additional non-consumer-facing use cases will emerge.

For this reason, it is imperative that the ULC draft a narrowly defined rule that is focused on use cases that pose consumer risk, the original impetus for this effort. Uses of the technology that do not pose the consumer risk should not be subject to the same rule.

Ripple’s proposition that regulation be based on use case is strongly supported by existing precedent. In fact, this use case approach is how regulation is written today. For instance, mortgages, swaps, and commodities are all financial assets, but are each regulated differently given their unique use and risk profile.

² “Virtual Currencies and Beyond: Initial Considerations” International Monetary Fund, January 2016, <http://www.imf.org/external/pubs/ft/sdn/2016/sdn1603.pdf>



Further the SEC's distinct treatment of notes within lending platforms Prosper and Kiva reinforces the precedent of regulating by use case. Both companies operate online lending platforms that connect lenders with borrowers. Loans on Prosper's platform are made with a defined interest rate and an expectation of return for the lender. For this reason, the SEC classified the notes on Prosper's platform as securities and subject to regulation under the Securities Act of 1933.³

However, loans made on Kiva's platform are not made with an interest rate or expectation of financial return. The SEC classified notes on Kiva's platform as gratuitous loans, which fall outside the definition of securities and beyond the purview of regulation.

Despite Prosper and Kiva both creating the same underlying asset – a financial note – the SEC treated each separately due to the different use cases and unique risk profiles. Such a precedent is important for the consideration of currency and non-currency use cases of emerging payment tools.

We urge the ULC to continue today's use case approach to regulation by providing a narrow, concrete, and clear definition and scope. A broadly defined rule that extends beyond consumer-facing tools used as currency will not effectively identify or mitigate risks, yet would unnecessarily restrict otherwise positive innovations in financial services.

³ Both analyses performed by the SEC under the *Howey* and *Reves* tests involve an expectation interest. Prosper's lenders generally expect a return in exchange for the use of their funds. See also <https://www.sec.gov/about/laws.shtml#secact1933> stating the purpose of the Securities Act of 1933 is investor protection.



21st Century Regulatory Models for 21st Century Technology

Ripple is very appreciative of the ULC's work, and applauds the leadership of several states who acted swiftly to establish consumers protection frameworks for this new technology.

Given the early state of the technology and its nascent adoption, Ripple feels it is a fair and opportune time to consider the ideal regulatory approach that would most effectively govern the broad adoption of these new tools.

The United States has a legacy of driving innovation and having a strong, respected regulatory regime. While regulatory models, specifically state-by-state licensing, have served us well in the past, it is prudent to periodically review the effectiveness of our models given:

1. the changing nature of technology,
2. the broadening scope of new financial activities, and
3. global developments impacting the United States's own competitiveness.

Given the unique characteristics, global scope, and great potential of new payment technologies, Ripple believes the legacy state-by-state licensing approach will not be the most effective model to govern virtual currency as it matures.

A state-by-state regime not only restricts innovation by making licensing unnecessarily burdensome, but also fails to serve regulators by limiting their ability to efficiently identify and mitigate growing risks.

We believe that today's fragmented approach poses a competitive disadvantage for the United States, undermining our role as a leader in innovation and jeopardizing the effectiveness of our regulatory efforts. As technology and risks evolve, regulatory models must also evolve to ensure their continued effectiveness. For these reasons, Ripple favors one national license for virtual currency activity.

We believe one national license lowers barriers to innovation, provides regulators with a broad view of risk, and ensures uniform consumer protections in a more efficient manner than other approaches.

Shaping Regulation In Context of Global Regulatory Developments

Other countries have already taken steps to modernize their regulatory and economic policies to support innovation and accommodate new technologies.⁴ Their efforts have been driven by a

⁴ Distributed Ledger Technology: beyond block chain, UK Government Office for Science, January 2016, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/492972/gs-16-1-distributed-ledger-technology.pdf



desire to spur growth, improve consumer services and better manage systemic risks. Ripple urges the ULC to consider developments in other countries and their impact on the United States competitiveness and reputation.

In 2014, The United Kingdom's primary regulator, the Financial Conduct Authority (FCA), launched an initiative to help start-ups understand the regulatory framework and how it applies to new technology. The initiative created an environment that supports innovation while ensuring the safety of their financial system.⁵

The Australian Securities and Investments Commission (ASIC) launched a similar innovation effort in April 2015. It was met with great success, having supported 75 startups and granting 10 new licenses for products that directly benefited Australian consumers.

Earlier this month, the UK's FCA and Australia's ASIC signed a groundbreaking agreement to support innovative fintech companies that wish to enter each others' markets. Christopher Woolard, director of strategy and competition at the FCA, stated, "Innovation in financial services isn't limited by national borders and so it's important that we support overseas businesses that have new ideas."⁶

Such an agreement and positive reception would not be possible in the United States, given that companies would face the burden of securing 50 state licenses before becoming broadly active – even if those 50 licenses were uniform in nature.

Europe has addressed regulatory fragmentation by creating the concept of "passportability." Under this approach, firms that obtain a license to conduct financial services in one European Economic Area are entitled to do business in all other European Economic Areas. Passporting streamlines registration processes and creates a supportive environment for safe, compliant innovation.⁷

This is in stark contrast to the United States where licenses are needed in nearly every state before a company can begin operating broadly. One national license would ensure the competitiveness of our country while balancing the need for a robust regulatory regime.

Developing an On-Ramp for Start-Ups

Ripple along with many other companies have called for regulators to develop an "on-ramp" for start-ups so they can innovate and grow in a safe, compliant manner. We urge policy makers to include a risk- and activity-based on-ramp to support innovation.

Other countries are developing on-ramps to support innovation and to give regulators first-hand exposure to new innovations, instead of playing catchup to market developments.

⁵ Financial Conduct Authority, "Project Innovate," <http://www.fca.org.uk/firms/firm-types/project-innovate>.

⁶ "British and Australian financial regulators sign agreement to support innovative businesses," FCA, 23 March 2016,

<http://www.fca.org.uk/news/regulators-sign-innovative-business-agreement>

⁷ Bank of England, Prudential Regulation Authority, <http://www.bankofengland.co.uk/pru/Pages/authorisations/passporting/default.aspx>.



For instance, FINMA, the Swiss financial market supervisory authority recently announced a licensing on-ramp for start-ups. The regulator stated:

Because the risks are lower and the scope of business limited, the licensing requirements would be less extensive than for a banking license.

For example, financial services providers who do not accept more than CHF 50 million in deposits could apply for this type of financial innovators' license provided they hold 5% of the deposits and at least CHF 300,000 capital as collateral.

The issuance of such licenses would lower the entry threshold for providers of payment systems, applications for managing assets digitally and crowdfunding platforms.⁸

Conclusion

In light of global efforts to support innovation, the United States must address its fragmented regulatory system if it aims to remain competitive globally. Otherwise, investments and future growth will shift to countries with more workable, coordinated regulatory frameworks.

To ensure the United States's competitiveness and the effectiveness of its regulatory regime, Ripple urges the consideration of one national virtual currency license that includes an on-ramp provision to support innovation.

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⁸ "Swiss regulator amends rules to allow fintech to flourish", Finextra, 18 March 2016, <https://www.finextra.com/newsarticle/28634/swiss-regulator-amends-rules-to-allow-fintech-to-flourish>

