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New York's Department of Financial Services: the Self-Styled "Regulator of the Future"

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Under its new leader, the New York Department of Financial Services ("DFS") has staked out high ground for itself by self-identifying as the "regulator of the future" DFS's pronouncement came in a July press release issued about a month after Linda Lacewell was confirmed as the agency's third superintendent. The press release, issued to announce the creation of a new Research and Innovation Division, signals that DFS is attempting to harness the increasing technological tools available to regulators, while making New York an attractive place for financial firms to do business. "The financial services regulatory landscape needs to evolve and adapt as innovation in banking, insurance and regulatory technology continues to grow," Lacewell said in the press release**.** "This new division and these appointments position DFS as the regulator of the future, allowing the Department to better protect consumers, develop best practices, and analyze market data to strengthen New York's standing as the center of financial innovation."

Further emphasizing the agency's commitment to innovation, Lacewell sourced her new division head from the tech industry itself, tapping veteran fintech executive, Matthew Homer, to be the Department's new Executive Deputy Superintendent in charge of the new division. At the time of his appointment, Homer was the head of policy and research at Quovo, a New York data analytics company providing open banking functionality.

The new division is not DFS's first time breaking new ground in the oversight of the rapidly evolving fintech sector. In 2015, DFS became the first government agency in the United States to enact regulations specifically targeting fintech companies and virtual currency businesses. *See* N.Y. Comp. Codes R. & Regs. Tit. 23 §200.1 *et seq*. These regulations revolve around the so-called "BitLicense." Any firm engaged in virtual currency business that involves a resident of New York – regardless whether the firm maintains a physical presence in New York – must have a BitLicense in order to operate. One particularly forward-thinking and industry-friendly element to the BitLicensing regime is its policy of allowing firms to operate in a safe harbor while their BitLicense application is pending. During this time, DFS reviews and comments on the applicant's compliance programs and cybersecurity measures, and provides opportunities for the applicant to correct any deficiencies prior to licensing.

In its first two months, the Research and Innovation division has already issued multiple virtual currency licenses. On August 16, 2019, DFS announced that it had granted a charter to Bakkt Trust Company LLC, a virtual currency trust company that provides custody services for institutional bitcoin investors in conjunction with the launch of physically delivered bitcoin futures contracts. In the Bakkt announcement, Lacewell touted DFS as being “at the forefront of fostering a sound, regulatory environment that continues to uphold New York as the premier place to do business,” and pointed to the approval as evidence of “New York’s competitiveness as a hub of innovation and leadership in emerging technologies.”

On September 5, 2019, DFS authorized Paxos Trust Company, LLC to offer both a price-stable cryptocurrency – commonly known as “stablecoin” – pegged to the U.S. dollar and Pax Gold (“PAXG”), a gold-backed crypto-asset. Lacewell again described the approvals as examples of DFS’s commitment to encouraging innovation and its “leadership in the virtual currency arena.”

Notwithstanding her desire to fashion DFS as the “regulator of the future,” Lacewell is also intent on maintaining DFS’s reputation as a no-nonsense regulator that puts consumer and market protection first. For example, Bittrex, Inc. (“Bittrex”), a Seattle-based cryptocurrency exchange, applied for a New York BitLicense in August 2015 and operated under DFS’s safe harbor provision for nearly four years. During that time, DFS identified a number of deficiencies regarding Bittrex’s Bank Secrecy Act/Anti-Money Laundering and OFAC compliance program and coin listing process and required Bittrex to take corrective action. This April, despite Bittrex’s customer base of approximately 1.67 million users spread across multiple countries and about 40 states, including 35,000 in New York, DFS denied Bittrex’s BitLicense application, citing Bittrex’s repeated failures to make the necessary corrections. Bittrex was ordered to immediately cease doing business in New York, and given 60 days to wind down its New York operations.

DFS appears intent on doing its part to make New York the jurisdiction of choice for virtual currency businesses while simultaneously maintaining its reputation as an exacting regulator of this industry. The Bittrex license denial reflects the tension between these dual aims – attracting business through innovative regulations on the one hand while still providing a safe marketplace for investors on the other. Time will tell if DFS is able to successfully strike this balance and truly become the “regulator of the future.”

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