



Office of the State Bank Commissioner

Guidance Document

MT 2014-01

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Regulatory Treatment of Virtual Currencies Under the Kansas Money Transmitter Act

Purpose

The purpose of this guidance document is to clarify the applicability of the Kansas Money Transmitter Act (KMTA)¹ to persons or entities engaging in the use and/or transmission of virtual currencies.² This guidance document provides the policy of the Office of the State Bank Commissioner (OSBC) regarding the regulatory treatment of virtual currencies pursuant to the statutory definitions of the KMTA.

Types of Virtual Currency

In broad terms, a virtual currency is an electronic medium of exchange typically used to purchase goods and services from certain merchants or to exchange for other currencies, either virtual or sovereign.³ As of the date of this memorandum (2014), the OSBC is not aware of any virtual currency that has legal tender status in any jurisdiction, nor of any virtual currency issued by a governmental central bank. As such, virtual currencies exist outside established financial institution systems. There are many different virtual currency schemes, and it is not easy to classify all of them, but for purposes of this document, they can generally be divided into two basic types: centralized and decentralized.

Centralized virtual currencies are created and issued by a specified source. They rely on an entity with some form of authority or control over the currency. Typically, the authority behind a centralized virtual currency is also the creator. Centralized virtual currencies can be further divided into subclassifications that quickly become too complex to apply a universal policy. Some can be purchased with sovereign currency but cannot be exchanged back to sovereign currency; some can be converted back to sovereign currency; some are used only for purchase of goods and services from a closed universe of merchants, while others may have a theoretically open

¹ Kansas Statutes Annotated 9-508 *et seq.*

² Much of this document is modeled after guidance issued by the Texas Department of Banking in Supervisory Memorandum 1037 and we thank them for allowing the OSBC to adapt it for use in Kansas.

³ As used in this document, sovereign currency refers to government-issued currency with legal tender status in the country of issuance, such as U.S. Dollars or Euros. This includes both government-issued fiat currency and commodity-backed currency that is designated as legal tender.

universe of merchants. Some centralized currencies are backed by the issuer with sovereign currency or precious metals, and therefore derive intrinsic value.

In contrast, decentralized virtual currencies are not created or issued by a particular person or entity, have no administrator, and have no central repository. Thus far, decentralized currencies are all cryptocurrencies such as Bitcoin, Litecoin, Peercoin, and Namecoin. A cryptocurrency is based on a cryptographic protocol that manages the creation of new units of the currency through a peer-to-peer network. The creation of cryptocurrency happens through a process called mining that basically involves running an application on a computer that performs proof-of-work calculations. When the computer performs a sufficient amount of these calculations, the cryptocurrency's underlying protocol essentially generates a new unit of the currency that can be delivered to the miner's wallet. Because users' wallets act as the connection points of the cryptocurrency's peer-to-peer network, transfers of cryptocurrency are made directly from wallet to wallet, without any intermediary, whereas transmissions of sovereign currencies must be made through one or more intermediaries such as a financial institution or money transmitter.

One important characteristic of cryptocurrency is its lack of intrinsic value. A unit of cryptocurrency does not represent a claim on a commodity and is not convertible by law. And unlike fiat currencies,⁴ there is no governmental authority or central bank establishing its value through law or regulation. Its value is only what a buyer is willing to pay for it. Most cryptocurrencies are traded on third party exchange sites, where the exchange rates with sovereign currencies are determined by averaging the transactions that occur. Some experts consider cryptocurrency to be a new asset class that is neither currency nor commodity, but possessing characteristics of both, as well as characteristics of neither.

Application of Kansas Money Transmitter Act to Virtual Currency

Currency Exchange

The act of two-party currency exchange by itself is not covered by the KMTA regardless of whether it is sovereign currency being exchanged or virtual currency. Further, it is not regulated by the OSBC. However, the presence of a third party involved in a currency exchange transaction will likely subject the transaction to the KMTA as "money transmission" and is discussed further below.

Money Transmission

This guidance document does not address money transmission activities involving the various centralized virtual currencies in existence. Many of these types of virtual currency schemes are complicated and nuanced and general guidance cannot adequately cover all the possible types of these currencies. Thus, operators engaging in activities that may be considered money transmission involving a centralized virtual currency will have to seek an individual licensing determination from the OSBC.

⁴ Fiat currency is government-issued legal tender, such as the U.S. Dollar. It has no intrinsic value and does not represent a claim on a commodity; its value is established by law.

This guidance is focused on money transmission activities involving decentralized cryptocurrencies, such as Bitcoin. Whether or not a Kansas money transmitter license is required for an entity to engage in the transmission of cryptocurrency turns on the question of whether cryptocurrency is considered “money” or “monetary value” under the KMTA. Money transmission is defined in statute and means “to engage in the business of receiving money or monetary value for transmission to a location within or outside the United States by...electronic means or any other means...”⁵ Money is not defined in statute, but Black’s Law Dictionary defines “money” as the “medium of exchange authorized or adopted by a government as part of its currency.” Since no cryptocurrency is currently authorized or adopted by any governmental entity as part of its currency, it is clear that cryptocurrency is not considered “money” for the purposes of the KMTA.

Monetary value, however, is defined in statute as “a medium of exchange, whether or not redeemable in money.”⁶ Medium of exchange is not defined by statute, but Black’s Law Dictionary defines “medium of exchange” as “anything generally accepted as payment in a transaction and recognized as a standard of value.” Cryptocurrencies are not generally accepted as payment in the current economy. While there may be a few retailers who are accepting Bitcoin or other cryptocurrencies, it is not generally accepted throughout the entire economy and does not even approach the extent to which U.S. Dollars (or other sovereign currencies) are accepted. Cryptocurrency also does not have a recognized standard of value. There is no set value for a single unit of a cryptocurrency. As stated above, the value of a unit of cryptocurrency is only what a buyer is willing to pay for it and what a seller is willing to accept in order to part with it. There is no intrinsic or set value for a unit of cryptocurrency.

Therefore, because cryptocurrencies as currently in existence are not considered “money” or “monetary value” by the OSBC, they are not covered by the KMTA. Since the KMTA does not apply to transmission of decentralized cryptocurrencies, an entity engaged solely in the transmission of such currency would not be required to obtain a license in the State of Kansas. However, should the transmission of virtual currency include the involvement of sovereign currency in a transaction, it may be considered money transmission depending on how such transaction is organized.

To provide further guidance, the regulatory treatments of some common types of transactions involving cryptocurrency are as follows:

- Exchange of cryptocurrency for sovereign currency between two parties is not money transmission under the KMTA. This is essentially a sale of goods between two parties. The seller gives units of cryptocurrency to the buyer, who pays the seller directly with sovereign currency. The seller does not receive the sovereign currency with the intent to transmit to another entity.
- Exchange of one cryptocurrency for another cryptocurrency is not money transmission. Regardless of how many parties are involved, since cryptocurrency is not considered “money” under the KMTA, no money transmission occurs.

⁵ K.S.A. 9-508(g).

⁶ K.S.A. 9-508(f).

- Transfer of cryptocurrency by itself is not money transmission. Because cryptocurrency is not money or monetary value, the receipt of it with the intent to transmit it to another entity is not money transmission. This includes intermediaries who receive cryptocurrency for transfer to a third party, and entities that, akin to depositories, hold cryptocurrencies on behalf of customers.
- Exchange of cryptocurrency for sovereign currency through a third-party exchanger is generally considered money transmission. For example, most Bitcoin exchange sites facilitate exchanges by acting as an escrow-like intermediary. In a typical transaction, the buyer of cryptocurrency sends sovereign currency to the exchanger who holds the funds until it determines that the terms of the sale have been satisfied before remitting the funds to the seller. Irrespective of its handling of the cryptocurrency, the exchanger conducts money transmission by receiving the buyer's sovereign currency in exchange for a promise to make it available to the seller.

Exchange of cryptocurrency for sovereign currency through an automated machine may or may not be money transmission depending on the facts and circumstances of its operation and the flow of funds between the operator of the automated machine and the customer. For example, several companies have begun selling automated machines commonly called "Bitcoin ATMs" that facilitate contemporaneous exchanges of bitcoins for sovereign currency. Most such machines currently available, when operating in their default mode, act as an intermediary between a buyer and a seller, typically connecting through one of the established exchange sites. When a customer buys or sells bitcoins through a machine configured in this way, the operator of the machine receives the buyer's sovereign currency with the intent to transfer it to the seller. This would be considered money transmission under the KMTA and would require licensure. However, at least some Bitcoin ATMs can be configured to conduct transactions only between the customer and the operator or owner of the machine, with no third parties involved. If the machine never involves a third party, and only facilitates a sale or purchase of bitcoins by the machine's operator directly with the customer, there is no money transmission because at no time is sovereign money received by the owner or operator of the machine with the intent to transfer it to another entity.

Additional Issues with Virtual Currency

- A cryptocurrency business that conducts money transmission, as outlined above, must comply with all applicable licensing, reporting, net worth, and other relevant requirements of the Kansas Money Transmitter Act under K.S.A 9-508 *et seq.*
- Any entity engaged in money transmission must comply with the permissible investment requirements of K.S.A 9-513b and as defined in K.S.A. 9-508(j). For purposes of allowed permissible investments, no virtual currency has been approved for use under this section by the Commissioner. Therefore, if a licensed money transmitter is seeking to comply with the

permissible investment requirement, it must have adequate U.S. currency or other approved investments to cover its outstanding payment instruments.

- For any entity intending to obtain licensing as a money transmitter, the OSBC will require any applicant who regularly handles virtual currencies in the course of its activities to submit a current third-party security audit of all relevant computer and information systems. Because of the increased risk that Kansas consumers may face when using the services of a money transmitter involved with virtual currencies, it is incumbent upon any license applicant to demonstrate that all of a customer's sovereign and virtual currency are secure while controlled by the transmitter.

This guidance document was originally issued on June 6, 2014 pursuant to K.S.A. 9-513 and K.S.A. 77-439. The Licensing Department has determined this guidance document has answered most virtual currency licensing questions since its issuance. However, this guidance document is only intended as general guidance. Any person engaged in virtual currency may request that the Licensing Department determine if their business model requires a license by submitting the following: a business plan, a diagram showing how fiat currency and/or virtual currency flows between persons, and a copy of any applicable contract.

The OSBC reserves the right to exercise its discretion in the application of this guidance document and it may edit, modify, or retract its interpretation at any time. Issued June 6, 2014; updated May 18, 2021.