ASSEMBLY FINANCIAL INSTITUTIONS AND INSURANCE COMMITTEE

STATEMENT TO

# ASSEMBLY, No. 1975

with committee amendments

# STATE OF NEW JERSEY

DATED: JUNE 2, 2022

The Assembly Financial Institutions and Insurance Committee reports favorably and with committee amendments Assembly Bill No. 1975.

As amended, this bill, known as the "Virtual Currency and Blockchain Regulation Act," establishes a regulatory framework for virtual currency businesses to operate in New Jersey, creates provisions governing the use of blockchain with certain business entities, and creates certain incentives for virtual currency businesses to locate in the State.

**Provisions on open blockchain tokens**

This bill provides that certain open blockchain tokens are intangible personal property rather than securities. An open blockchain token is to be considered intangible personal property under the bill if it meets certain characteristics enumerated in the bill.

The bill requires that, before making an open blockchain token available for sale, the developer or seller of a token, or the registered agent of the developer or seller, is to electronically file a notice of intent with the Department of Banking and Insurance (department) and pay a filing fee of $1,000. The notice of intent is to contain the name of the person acting as a developer or seller, the contact information of the person, or the registered agent of the person and comprehensive details, to be determined by the Commissioner of Banking and Insurance (commissioner), on the open blockchain token made available for sale. A form is to be made available by the department for this purpose, and is to include a secure electronic form conspicuously posted on the department's Internet website. A developer, seller and the registered agent of these persons, if applicable, is to have a continuing duty to update the contact information provided on a notice of intent as long as the open blockchain token associated with the notice is actively being sold.

The bill provides that a willful failure by a developer, seller, or facilitator to comply with the duties imposed by the bill is an unlawful practice under the consumer fraud act. An unlawful practice under the

consumer fraud act is punishable by a monetary penalty of not more than $10,000 for a first offense and not more than $20,000 for any subsequent offense. In addition, violations can result in cease and desist orders issued by the Attorney General, the assessment of punitive damages and the awarding of treble damages and costs to the injured party.

**Provisions on digital assets as property**

This bill establishes digital assets as property and allows qualified financial institutions to provide custodial services for digital assets.

A digital asset is a representation of an economic, proprietary, or access right that is stored in a computer readable format, and includes digital consumer assets, digital securities, and virtual currency. Under the bill, all digital assets will be classified as property, with digital consumer assets classified as a general intangible property, digital securities classified as a security, and virtual currency classified as money. A digital asset is to also be treated as a financial asset under the bill if a written agreement is entered with the owner of the digital asset classifying the asset as such. If the digital asset is treated as a financial asset, then the digital asset will remain as intangible personal property. Any digital asset that is treated as a security is not subject to the bill and must comply with applicable State and federal laws regarding securities.

Under the bill, a secured party or an agent, custodian, fiduciary, or trustee of the party with a security interest in a digital asset will be able to perfect their security interest through control. A secured party holding a security interest in a digital asset through control will have priority over a secured party that has a security interest in the asset but does not have control. Perfection by control will create a possessory security interest in a digital asset and will not require physical possession.

Additionally, the bill is to allow a qualifying financial institution to provide custodial services of digital assets upon providing 60 days written notice to the commissioner. A qualifying financial institution that elects to serve as a qualified custodian must follow federal Securities and Exchange Commission rules regarding custodial services and must ensure certain requirements enumerated in the bill.

The bill provides that a qualifying financial institution providing custodial services is to be required to enter into an agreement with an independent public accountant to conduct an examination that conforms to federal regulations concerning custodial services, at the cost of the qualifying financial institution, pursuant to certain rules and requirements.

The bill also provides that digital assets held in custody are not depository liabilities or assets of the qualifying financial institution. A qualifying financial institution, or its subsidiary, that holds digital assets in custody will be able to register as an investment adviser,

investment company or broker dealer as necessary. Qualifying financial institutions holding digital assets in custody are required to maintain control over a digital asset, with the customer electing, pursuant to a written agreement with the qualifying financial institution.

A qualifying financial institution that holds a digital asset in custody under a bailment that allows the bank to undertake transactions with the digital asset will not be liable for any loss suffered with respect to any transactions made, except for liability consistent with fiduciary and trust powers as a custodian.

The bill requires a qualifying financial institution and a customer to agree in writing with regard to the source code that the qualifying financial institution will use for each digital asset, and the treatment of each asset. Any ambiguity within the agreement will be resolved in favor of the customer. A qualifying financial institution will be required to provide clear, written notice to each customer, and require written acknowledgement, of certain information provided in the bill.

A qualifying financial institution and a customer are to agree in writing to a time period within which the bank would return a digital asset held in custody. If a customer elects to allow the qualifying financial institution to make transactions with the asset, then the bank and the customer may also agree in writing to the form in which the digital asset will be returned.

The bill provides that all ancillary or subsidiary proceeds relating to digital assets held in custody are to accrue to the benefit of the customer, except as specified by a written agreement with the customer. The bank may elect not to collect certain ancillary or subsidiary proceeds, as long as the election is disclosed in writing. A customer who elects to custody under a bailment that treats a digital asset as either fungible or nonfungible may withdraw the digital asset in a form that permits the collection of ancillary or subsidiary proceeds.

Finally, the bill provides that a qualifying financial institution is to be prohibited from authorizing rehypothecation of digital assets. The bank is not to engage in any activity to use or exercise discretionary authority relating to a digital asset unless it has the customer's instructions to do so. The bill prohibits a bank from taking any action which would likely impair the solvency or the safety and soundness of the bank, as determined by the commissioner after considering the nature of custodial services customary in the banking industry.

**Provisions on decentralized autonomous organizations**

This bill allows the formation of decentralized autonomous organizations (DAO) under the State's limited liability company law.

A DAO is an organization controlled by its members with no central authority. Instead, the organization is governed by a set of smart contracts built on distributed ledger technology or blockchain.

The smart contracts automate many of the decision-making processes typically reserved for upper-tier management in a traditional company.

The bill permits DAOs to incorporate as limited liability companies and provides DAOs with similar protections as are afforded to limited liability companies under current law.

The bill provides that a DAO is a limited liability company whose articles of organization contain a statement that the company is a decentralized autonomous organization. The bill requires DAOs to maintain a presence in the State through a registered agent and to include in its name a designation such as "DAO," "DAO LLC," or "LAO." The bill permits limited liability companies in the State currently to convert to DAOs by amending their articles of organization.

Under the bill, a DAO may be member managed or algorithmically managed, as set forth in its articles of organization. If algorithmically managed, the underlying smart contract is to be able to be updated, modified, or otherwise upgraded.

The bill provides that the articles of organization or the smart contracts of the DAO are to govern aspects of the organization such as relations among the members, rights and duties of each member, voting rights, transferability, distributions, and amendments. In addition, unless provided for in the articles of organization or operating agreement, no member would have any fiduciary duty to the DAO or any member other than the implied contractual covenant of good faith and fair dealing.

**Provisions on blockchain filing system**

This bill gives the Division of Revenue and Enterprise Services in the Department of the Treasury (division) the authority to develop a filing system using blockchain through which all required filings may be submitted. The division is to try to use blockchain technology and include an application programming interface as components of the filing system, as well as robust security measures and other components determined by the division to be best practices or which are likely to increase the effective and efficient administration of the laws of this State. The division may create a blockchain or contract for the use of a privately created blockchain.

The division may consult with all interested parties and partner with technology innovators and private companies to develop necessary components of the system. The division may also promulgate rules and regulations to effectuate the provisions of the bill.

**Exemption for virtual currency from money transmitter law**

This bill also exempts virtual currency from current law governing money transmitters. "Virtual currency" is added to the law to mean any type of digital representation that: 1) is used as a medium of

exchange, unit of account, or store of value; and 2) is not recognized as legal tender by the federal government.

**Authorization for business entity to issue stock as certificate token**

This bill authorizes a business entity, such as a corporation or limited liability company, to issue stock certificates in the form of electronic certificate tokens. "Certificate token" is defined as an electronic representation of a share of stock which contains certain information required under existing law for stock certificates and which is entered into a blockchain or other secure, auditable database.

**Business incentives for virtual currency businesses**

The bill also provides certain incentives for virtual currency businesses to locate in New Jersey. The bill exempts receipts from retail sales of energy and utility service to a virtual currency servicer or registrant for use or consumption directly and primarily in the creation of virtual currency, including mining, from the tax imposed under the "Sales and Use Tax Act." The bill provides that a virtual currency servicer or registrant may file an application for a sales and use tax exemption with the Director of the Division of Taxation in the Department of the Treasury.

The “Grow New Jersey Assistance Act” provides certain business and insurance premiums tax credits for job creation and retention in New Jersey. For the purposes of the “Grow New Jersey Assistance Act,” the bill designates virtual currency servicers and registrants registered pursuant to this bill’s provisions to be in a “targeted industry” and a “technology startup company.”

A virtual currency servicer must provide a plan designed to mitigate or offset any carbon emissions produced by the virtual currency servicer before receiving any tax incentives.

**Allowance for virtual currency in payment of State taxes**

Current law allows the Director of the Division of Taxation to establish an electronic funds transfer system for payments of State taxes. The bill amends the definition of "electronic funds transfer" to include any transfer of virtual currency.

COMMITTEE AMENDMENTS:

The committee amended the bill to:

(1) remove digital assets that are securities from the provisions of the bill;

(2) replace the term “bank” with “qualifying financial institution” in order to allow credit unions to provide custodial services in addition to banks;

(3) state that a membership interest in a decentralized autonomous organization may be characterized as a digital consumer asset, instead

of a digital security or digital consumer asset as previously written; and

(4) require virtual currency servicers to provide a plan to mitigate or offset any carbon emissions produced by a virtual currency before receiving any tax exemptions or credits pursuant to the bill.