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United States Senate

COMMITTEE ON
HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

WASHINGTON, DC 20510-6250

August 12, 2013

The Honorable Janet Napolitano
Secretary of Homeland Security
U.S. Department of Homeland Security
Washington, D.C. 20528

Dear Secretary Napolitano:

Over the past several months, “virtual currencies” have received increasing attention from law enforcement, the business community, the financial sector, and the federal government. As you probably know, virtual currencies are digitally-based money that can be quickly sent between entities over the Internet and that have no central bank or government entity that backs them. They can be sent nearly anonymously, leaving little or no trail for regulators or enforcement agencies. The speed at which payments can be sent globally and the potentially profitable investments that can be made trading virtual currency have made them attractive to entrepreneurs and investors alike. However, their near anonymous and decentralized nature has also attracted criminals who value few things more than being allowed to operate in the shadows.

While issues surrounding virtual currencies continue to emerge, the technology is receiving increased mainstream attention and investment. Last month, for example, the Securities and Exchange Commission charged a Texas man with running a virtual currency Ponzi scheme through which he raised about \$60 million worth of Bitcoin, a widely-known virtual currency, and issued an alert recommending that investors be wary of virtual currency investment opportunities promising high rates of return with little or no risk.¹ The defendant in the case argued that the Court had no jurisdiction, since Bitcoin is not money and not part of anything regulated by the United States. The Court, however, concluded that Bitcoin is a currency or form of money. This case is just the most recent incident where government has taken law enforcement or regulatory action related to virtual currencies. It’s not likely to be the last.

As you may know, a filing was made with the Securities and Exchange Commission in July of this year to create an exchange-traded fund based on Bitcoin, allowing institutional investors to begin trading the currency.² The Government Accountability Office recently

¹ SEC. EXCHANGE COMM’N, PONZI SCHEMES USING VIRTUAL CURRENCIES (2013), *available at* http://www.investor.gov/sites/default/files/ia_virtualcurrencies.pdf.

² The Securities and Exchange Commission recently received an S-1 registration statement for creation of an exchange-traded virtual currency trust. *See* Winklevoss Bitcoin Trust Registration Statement, Form S-1

issued a report³ calling for increased guidance from the Internal Revenue Service on virtual currencies⁴, citing potential tax vulnerabilities. Earlier this year, Immigration and Customs Enforcement's Homeland Security Investigations seized a bank account connected with the largest virtual currency exchange.⁵ And in March, the Financial Crimes Enforcement Network (FinCEN) issued guidance clarifying regulations for those who are administering, exchanging, or using virtual currencies.⁶

Given that virtual currencies appear to be an important emerging area, pursuant to its authority under Rule XXV(k) of the Standing Rules of the Senate, Section 101 of Senate Resolution 445 (108th Congress), and Section 12(c) of Senate Resolution 64 (113th Congress), the Committee on Homeland Security and Governmental Affairs has initiated an inquiry into virtual currencies. As part of that inquiry, our Committee staff has been interviewing individuals inside and outside of government regarding the threats and risks related to virtual currency – and also the promise it holds in some areas. The expansive nature of this emerging technology demands a holistic and whole-government approach in order to understand and provide a sensible regulatory framework for their existence. As with all emerging technologies, the federal government must make sure that potential threats and risks are dealt with swiftly; however, we must also ensure that rash or uninformed actions don't stifle a potentially valuable technology.

Members of your staff have provided briefings to our Committee's staff related to this issue. We thank you and them for their time and preparation. In the coming days and weeks, we will be reaching out to additional offices and agencies within your department. We thank you in advance for your continued cooperation and assistance.

With that thought in mind, and in order to assist the Committee further with its inquiry, we ask that you please provide the following:

- 1) any policies, procedures, guidance, or advisories related to the treatment or regulation of virtual currencies and any minutes of interagency working groups involved in the development of any such policies, procedures, guidance, or advisories;

(2013), available at <http://www.sec.gov/Archives/edgar/data/1579346/000119312513279830/d562329ds1.htm>.

³ GOV'T ACCOUNTABILITY OFFICE, GAO-13-516, VIRTUAL ECONOMIES AND CURRENCIES (2013) available at <http://www.gao.gov/assets/660/654620.pdf>.

⁴ See, e.g., 2008 IRS NAT'L TAXPAYER ADVOCATE ANNU. REP. TO CONGRESS ch. MSP-13, at 214–26, available at http://www.irs.gov/pub/irs-utl/08_tas_arc_intro_toc_msp.pdf.

⁵ See, e.g., Affidavit in Support of Seizure Warrant at 3, In the Matter of the Seizure of The contents of one Dwolla account, No. 13-1162 (SKG) (D. Md. seizure warrant issued May 14, 2013) (seeking and receiving a warrant for the seizure of a bank account of a large virtual currency exchange).

⁶ DEP'T OF THE TREASURY FIN-2013-G001 (2013), available at http://fincen.gov/statutes_regs/guidance/pdf/FIN-2013-G001.pdf.

- 2) information related to any ongoing coordination of your agency with any other federal agencies or state and local governments related to the treatment of virtual currencies; and,
- 3) any plans or strategies regarding virtual currencies and information regarding any ongoing initiatives you have engaged in regarding virtual currencies and the name of the person most knowledgeable about any such plans, strategies, or initiatives.

Thank you again for your attention to this matter. We ask that you please provide the above requested information by August 30, 2013. If you have any questions, please contact [REDACTED] of Senator Carper's staff at [REDACTED] and [REDACTED] of Senator Coburn's staff at [REDACTED].

With best personal regards we are,

Sincerely yours,



Thomas R. Carper
Chairman



Tom A. Coburn, M.D.
Ranking Member