

KATHY HOCHUL
Governor



ADRIENNE A. HARRIS
Superintendent

May 8, 2024

The Honorable Kathy Hochul
Governor of New York State
NYS Capitol Building
Albany, New York 12224

Re: Department of Financial Services - Virtual Currency Licensing Report 2022-S-18

Dear Governor Hochul:

As required by Section 170 of the Executive Law, the Department of Financial Services (the "Department") hereby submits its response to the Office of the State Comptroller ("OSC") audit report entitled "Department of Financial Services - Virtual Currency Licensing Report 2022-S-18" (the "Audit Report"). In accordance with the provisions of Section 170, this report is also being submitted to the State Comptroller, leaders of the State Senate and State Assembly, and the Senate Finance Committee and the Assembly Ways and Means Committee.

DFS appreciates the opportunity to respond to the Audit Report and values OSC's work in undertaking this review and the findings contained in the Audit Report. Under Superintendent Harris' leadership, DFS self-identified and began remediating a majority of the issues identified in the OSC's Audit Report before the audit commenced. As DFS noted in its response to OSC's draft report, OSC's recommendations either (1) encouraged DFS to "continue" with what it is already doing, or (2) recommended DFS adopt policies, procedures, and templates that DFS independently identified and either adopted and provided to the OSC for review or was in the process of adopting before the close of the audit period.

As discussed in greater detail below, since the closing of the audit, DFS has built on its prior proactive approach and continued to strengthen its operational framework. Specifically, under Superintendent Harris' leadership, DFS has continued hiring new virtual currency staff; rolled out comprehensive and robust financial analysis tools established by the Virtual Currency Unit ("VCU"); and established a dedicated internal controls function within VCU, which is charged with enhancing governance protocols, consulting with management and teams to ensure effective processes, and periodically reviewing compliance with established policies and procedures. DFS's efforts to create and maintain a comprehensive, nation leading virtual currency regulatory regime have remediated the findings in the OSC Audit. Additional actions are noted in the responses that follow.



Application Process Policies and Oversight

OSC Recommendation 1: “Continue to take steps to ensure that all BitLicense applications are complete and comply with Part 200.4 requirements, any issues are addressed prior to approval, and decisions and actions taken on an application are documented.”

DFS Response: As noted in DFS’s response to the OSC Audit Report, DFS addressed this recommendation by adopting—and subsequently refining—new and strengthened applications processes and procedures in June 2022, after the current administration independently identified a lack of formalized policies and procedures. Additionally, since the close of the audit DFS has worked diligently with the Department of Taxation and Finance (“DTF”) to establish an automated process to verify applicants’ tax compliance pursuant to Part 200.4(a)(12). DFS has signed an agreement, and is awaiting full execution by DTF, to proceed with implementation of this new process.

OSC Recommendation 2: “Develop formal, written guidance for Specialty Reviews to ensure comprehensive and consistent application reviews.”

DFS Response: As noted in DFS’s response to the OSC Audit Report, DFS addressed this recommendation in November 2022 by adopting a new Financial Applications Review Template that is completed by a financial subject matter expert during the application process, after current DFS leadership independently identified this as an area for improvement. DFS also conducts and documents specialty reviews of an applicant’s AML and Cybersecurity programs with an established format to ensure consistency. Since the close of the audit, DFS has continued to utilize the Financial Applications Review Template, as well as procedures specific to AML and Cybersecurity, in its review of BitLicense applications. DFS will continue to enhance its specialty review process as appropriate.

Supervision of BitLicensees

OSC Recommendation 3: “Take steps to ensure BitLicensees provide all information as required by Part 200 and the Supervisory Agreements.”

DFS Response: As noted in DFS’s response to the OSC Audit Report, DFS addressed this recommendation in September 2023 by adopting enhanced processes and Periodic Reporting Procedures, after current DFS leadership independently identified this as an area for improvement. Since the close of the audit, DFS has continued to use these Procedures and monitors BitLicensees for submission of required information.

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OSC Recommendation 4: “Continue to develop and implement procedures and tools to collect and analyze required information to ensure the safety and soundness of BitLicensee operations.”

DFS Response: As noted in DFS’s response to the OSC Audit Report, DFS addressed this recommendation by introducing quarterly financial analysis, a report for comprehensive financial review, and other enhanced tools. Since the close of the audit, DFS has completed rollout of annual analysis and fiscal strength ratings for all BitLicensees.

Examinations and Follow-Up

OSC Recommendation 5: “Continue to develop and implement policies and procedures to ensure safety and soundness examinations are conducted in a timely manner.”

DFS Response: As noted in DFS’s response to the OSC Audit Report, DFS has tripled its VCU staff and examiner-in-charge pool, after current DFS leadership independently identified resources for exam and BitLicense oversight as a priority area for improvement. Since the close of the audit, DFS has continued its hiring efforts, growing its virtual currency staff by approximately 10 employees.

OSC Recommendation 6: “Establish formal policies and procedures for the examination follow-up process to ensure issues are addressed promptly.”

DFS Response: As noted in DFS’s response to the OSC Audit Report, DFS addressed this recommendation in April 2023 by adopting formal policies and procedures for ROE follow-up, after current DFS leadership independently identified this as an area for improvement. DFS has continued to use these policies and procedures.

Sincerely,

A handwritten signature in black ink that reads "Bruce Rollins".

Bruce Rollins, Director of Internal Audit
New York State Department of Financial Services