Executive Summary.

This essay examines the Illinois Digital Asset Regulation Act (DARA), currently under consideration, which proposes significant changes to Illinois laws addressing value transmission businesses. DARA applies to all *transfers* of digital assets, while laws regulating analogous businesses that deal in fiat money only cover *transmissions*. Indeed, even New York and California's attempts to regulate digital asset activity separately from money transmitters— just like DARA would in Illinois—explicitly limit their scope to *transmissions* of digital assets.

Transmission is not synonymous with transfer. A transmitter is merely an intermediary business that takes at least temporary custody of the customer's value to transfer that value on behalf of the customer. Transfers apply more broadly, and because individuals transfer value as part of daily life, it would be improper to regulate mere transfers as a business activity requiring approval from the state. Yet DARA does exactly that when a digital asset and not fiat money is involved.

In short, because DARA applies to all *transfers* of digital assets and not only *transmissions* of digital assets, it would apply to individual, personal (i.e., nonbusiness) interactions with and uses of digital assets. And while the legislation states that its goal is robust consumer protection, DARA's provisions do not advance that cause.

This paper argues that the FTX collapse influenced the legislature's desire to pass regulations quickly in the name of consumer protection. DARA, however, cannot and would not prevent another FTX. Instead, DARA's extreme licensing prerequisites and compliance obligations make it impossible for good-faith innovators to qualify for a license, subjecting them to heavy civil penalties if they ever transfer a digital asset involving an Illinois resident—something any crypto enthusiast, let alone noncustodial digital asset startup business, will inevitably run afoul of. Innovators' only option, therefore, is to leave the state entirely.

Passing DARA in its current form would stifle innovation and economic productivity, encourage deceptive practices, hinder fair competition in favor of entrenched interests, and expose Illinois consumers to greater risk of harm. Rather than rushing through a half-baked, arguably discriminatory regulatory regime for digital asset businesses, regulating them under the existing framework for money services businesses would be more prudent.

The essay thus proposes the following alternative approach: amend the Transmitters of Money Act (TOMA) to cover digital asset *transmission* as a category of money transmission. This approach would: (1) subject FTX-like digital asset businesses that custody customers' assets to regulation designed to protect consumers from the harms that can result from that relationship; (2) avoid subjecting noncustodial digital asset businesses and innovators to unnecessary and prohibitively expensive licensing and regulation; and (3) avoid subjecting individual enthusiasts to massive civil penalties for personal interactions with digital assets as if they were an unlicensed for-profit business.

Introduction.

The Illinois Digital Asset Regulation Act (DARA), currently under consideration, proposes two significant changes to Illinois law: (1) Section 10 replaces the Transmitters of Money Act (TOMA) with the Money Transmission Modernization Act (MTMA), and (2) Section 101 establishes new regulations requiring digital asset (DA) exchanges and other DA businesses to obtain a specific license from the Illinois Department of Financial and Professional Regulation (IDFPR) before engaging in any "digital asset business activity."

In most US states, cryptoasset businesses and traditional money transmitters are regulated under a single Money Transmission statute. In Illinois, the IDFPR has been regulating these businesses under TOMA. While TOMA presents a substantial barrier to entry for businesses in the crypto space, a dedicated, well-funded startup business can at least hope to obtain licensure and operate in compliance with consumer protections.

Generally, US state money transmitter regulations focus on protecting consumers when intermediary businesses transmit money or monetary value on their behalf. This is necessary due to the unique nature of the relationship and the potential for businesses to misuse customers' money to their advantage, causing harm to the customer.

Transmission activities, whether in terms of a dictionary definition, a statutory term, or federal court interpretations, are limited to *specific transfers* with certain characteristics that necessitate consumer protection. A business that transmits money *transfers* money "on behalf of another for a fee" by taking custody or control of the other's money or value, at least momentarily.

In short, transmission involves an intermediary business charging a fee to facilitate a transfer between a sender and a recipient. This regulatory framework targets transmission activities—and not mere transfers—because consumers are particularly vulnerable to fraud and other harm when entrusting their money or other value to a third party.

This distinction is crucial; If the statute included any *transfer* of money or value as licensable activity, the entire economy would stall, as individuals would need to apply for a license from the state for simple transactions like purchasing a soda at a convenience store.

However, Illinois' proposed DARA deviates from the traditional approach and does precisely that when a digital asset is involved.

DARA is impermissibly broad because it extends to any conceivable digital asset activity that involves an Illinois resident.

DARA's scope extends beyond intermediary digital asset businesses that take custody of a customer's digital assets and perform specific actions on their behalf for financial gain.

While there are other glaring problems with DARA—see, for example, the chart below showing the differences between the analogous licensing and regulatory obligations predicated only on

the involvement of a digital asset and not fiat money—this paper focuses on the IL legislature's fundamental misunderstanding of what kinds of activity are proper subjects of regulation in the name of consumer protection.

DARA applies to all *transfers* of digital assets, while the MTMA—consistent with its predecessor, TOMA—remains limited to money transmissions. To illustrate the difference between these related but inconsistent provisions, a side-by-side comparison is beneficial.

MTMA §10	**DARA** §110
"Money transmission" means any of the following:	"Digital asset business activity" means any of the following:
(1) Selling or issuing payment instruments [***transmission*** because they sell an instrument for a fee that facilitates the transfer of money between two parties and they take custody of the funds the instrument represents]	(1) Exchanging, ***transferring***, or storing a digital asset.
(2) Selling or issuing stored value [same as above]	(2) Engaging in digital asset administration.
(3) Receiving money for ***transmission*** from a person located in this State or ***transmitting*** money in this State	(3) ***Any other business activity*** involving digital assets designated by rule by the Department ***as may be necessary and appropriate for the protection of residents***.

Under the Money Transmission Modernization Act (MTMA), transmission and transmitting adhere to the traditional understandings of those terms, limiting their scope to custodial relationships that per se imply a risk of harm to the consumer.

The Digital Asset Regulation Act (DARA), however, covers "transferring" a digital asset. DARA further defines "transfer" as "the process of *TRANSFERRING OR transmitting* a digital asset *FROM OR* on behalf of a resident," including any of the following actions: (1) Crediting the digital asset to another person's account or storage, (2) Moving the digital asset from one account or storage of a resident to another account or storage of the same resident, or (3) relinquishing custody or control of a digital asset to another person.

Remember that transmission is merely a type of transfer with specific characteristics. Therefore, including "transferring or transmitting" does nothing to limit the potential scope of this law. "Transferring…from…a resident" covers both general transfers of digital assets AND those special transfers of value that are the only proper subject of regulation: transmissions.

In contrast to every available related law—even those that like DARA, purport to merely apply money transmissions to digital asset transmission—DARA does not specifically limit its scope to those "transfers" conducted by an intermediary, for profit, where the intermediary takes at least temporary custody of the customer's value. Instead, the bill grants the authority for unelected officials to apply this law to nearly any conceivable activity involving digital assets. When combining DARA's definitions of "digital asset business activity" and "transfer," an IL person who "relinquish[es] custody or control of a digital asset to another person" has engaged in transferring" a digital asset and thus "digital asset business activity" under the act. If they have not applied for and received a license from the IL IDFPR before doing so, they have violated DARA and are subject to two civil penalty provisions: one for unlicensed digital asset business activity and the other for violating certain compliance provisions of DARA that apply not only to licensed businesses but "any person."

For example, if an Illinois resident transfers $25 worth of ETH from their self-hosted wallet to another person's self-hosted wallet to repay them for dinner last night, they have engaged in digital asset business activity.

If that person is not licensed before the transfer occurs, they are subject to a civil penalty of $100,000 per day civil penalties for engaging in unlicensed "digital asset business activity." In addition, "any person" (i.e., licensed or unlicensed) who violates a specific provision of DARA is subject to an additional civil penalty of $25,000 per violation per day with no maximum amount.

Here, the civil penalty for repaying a friend for dinner in a digital asset and not US dollars is much higher than if the same person had, for example, started a for-profit business issuing a payment instrument representing funds the business maintains custody of on behalf of the customer without a license under the MTMA. This is an absurd outcome, given that the latter hypothetical presents the opportunity to abscond with the customer's money under their control, keeping for themselves the entire value of the actual funds while the customer is left with a now-worthless payment instrument.

Moreover, a comparison of DARA to the New York BitLicense and the vetoed California "Digital Financial Asset Regulation Act" (CA DFARA)—both widely criticized for their broad scope and incredibly onerous, expensive, and limiting application and licensing process—highlights the immense threat DARA poses to the digital asset industry, going so far as to penalize individual interactions with and uses of an entire technology.

Although relevant Illinois legislators claim that the New York BitLicense inspired DARA and they are only attempting to have Illinois follow New York's lead in providing regulatory clarity for digital assets, the significant differences in their scope show that is not true.

In contrast to DARA, and consistent with TOMA, the MTMA, and every other money transmission regime today, the BitLicense and the CA DFARA apply only to *transmissions* of digital assets. That is, the bills either take care to only use forms of the word transmit and not

the more general transfer or explicitly limit the term "transfer" to those that involve the key relationship that triggers a need for regulation and thus also only covers "transmissions" despite the use of the word "transfer."
Note that the bills are structured differently and have been reorganized to have analogous provisions side-by-side to show how the same kinds of activities are regulated in relation to the other approaches.

DARA §101 "Digital Asset Business Activity" = exchanging, ***transferring*** or storing a digital asset…	Vetoed CA bill "Digital Financial Asset Business Activity" = exchanging, ***transferring***, or storing a DFA…	New York BitLicense "Virtual Currency (VC) Business Activity" (VCBA) =
Exchange = buy, sell, trade, or convert…on behalf of a resident [no custody/control and does not have to be for profit or on behalf of a customer]	**Exchange** = *TO ASSUME CONTROL* from, or on behalf of, a resident, at least momentarily, to sell, trade, or convert	Buying and selling VC *as a customer business*
Transfer = to ***transfer*** or transmit ***from*** or on behalf of a resident, including by doing any of the following… [i.e., transfer = transfer from a resident because includes all the other combos of these four words] ["transfer…from…a resident" on its face covers any IL person moving a digital asset; that's why CA explicitly limits its "transfers" to those where an intermediary assumes— even temporarily—control	**Transfer** = TO ASSUME CONTROL of a DFA on behalf of a resident by a person OTHER THAN A RESIDENT and to subsequently do any of the following…	Receiving VC for ***transmission or transmitting*** VC (except for nonfinancial purposes and not involving more than a nominal amount of VC) [control/custody + profit + on behalf of another all implicit in choice of word "transmit" without the more general "transfer"]

of the customer's funds and further limits the term by disallowing someone doing it for themself as a covered activity]		
Store = to store, hold, or maintain custody or control of a DA on behalf of a resident	**Store** = TO MAINTAIN CONTROL of a DFA on behalf of a resident by a person other than the resident	Storing, holding, or *maintaining custody or control* of VC *on behalf of others*
[could apply to a person maintaining custody of their own digital assets]		

Treating non-custodial digital asset *transfers* as a higher risk activity than custodial money *transmitter* businesses suggests an intent to discriminate against digital asset activity in Illinois.

Were these clearly contradictory approaches not enough, consider the near-universal legal baseline for states regulating value transmission up to the invention of digital assets. Traditionally, US states only regulated the transmission of fiat currencies, but as novel payment systems—e.g., the Visa payment network—and their associated instruments for transmission on that system proliferated, states generally expanded the coverage to instruments that facilitate the transmission of money when the instrument itself qualifies as "monetary value." Monetary value is defined as a medium of exchange. A medium of exchange is an instrument widely or commonly accepted as payment for goods and services.

Here, for example, issuing a prepaid Visa debit card became a regulated money transmission activity because the card is an instrument that facilitates the transfer of actual money on behalf of the public, the company issues it in return for a fee, and the issuer takes custody of the funds the card represents. The card is regulated as monetary value because it is widely accepted by merchants using the Visa Payment Network.

Until now, IL has never officially considered any digital asset to be a form of monetary value (because not yet widely accepted as payment) and especially not actual money (because money

is only fiat currency that is satisfactory payment of a debt by law)—possibly to avoid legitimizing this emerging industry.

However, under the clear terms of DARA and the MTMA, the IDFPR is now poised to regulate for-profit businesses that take custody of IL customers' actual fiat money with less oversight and fewer compliance burdens than those IL individuals who merely *transfer* a digital asset—even for purely personal purposes with no risk of harm to another consumer. This would apply to all digital assets even those not not yet accepted as payment and thus not even properly considered monetary value. Despite this, DARA's stated purpose is consumer protection.

Far from showing an intent to enact robust consumer protections, a side-by-side comparison of the two proposed regulatory regimes betrays an intent to discriminate against a disfavored industry.

Remember that the MTMA governs specific for-profit activities on behalf of the public involving taking custody of customers' actual money, while DARA broadly regulates transfers of digital assets even where no profit is involved and there is no consumer-facing business that takes custody of funds. Given the increased risk of consumer harm in the former, one would expect to see more compliance obligations, heavier civil penalties for violations, and more stringent prerequisites for qualifying for a license under the MTMA. The exact opposite is true.

Money Transmitter Modernization Act (MTMA) (§10 of the proposed bill)	**Digital Asset Regulation Act (DARA) (§110 of the bill)**
IDFPR must approve/deny a valid license application within 120 days	IDFPR must approve/deny/conditionally approve "after completing the investigation" (i.e., no obligation to ever respond)
Must explain a denial within 30 days of denial and applicant may request a hearing if denied. If IDFPR does not within 30 days, the application is deemed APPROVED	No explanation is required for denial (or anything for that matter). The applicant is not entitled to a hearing upon a denial. If the applicant does not respond to any condition of approval within 31 days, application deemed WITHDRAWN.
More "permissible investments"	Fewer permissible investments
"Person" = individuals and "corporate entities"	"Person" = individuals and "any organization"
Civil Penalty for unlicensed money transmission in IL = greater of $5K or 3x the value of ALL PROFITS made without	Civil penalty for unlicensed digital asset business activity in IL = up to $100,000 PER DAY

a license	
Civil penalty for a LICENSED money transmitter violating a specific provision/requirement of the MTMA = $1000/txn in violation/day	Civil penalty for ANY PERSON (i.e., licensed or unlicensed) violating a specific provision of DARA = $25,000/violation/day (up to an unlimited amount) ($75,000/violation/day if fraud involved in the violations)
Funds paid into the "consumer protection fund" shall be used solely for the purpose of providing restitution to consumers who have suffered monetary loss arising out of a transaction regulated by this Act.	Funds paid into DARA consumer protection fund may be transferred to any other IL regulatory department fund and may be used to pay employees' salaries, retirement, and benefits. [severely undercuts the stated purpose of protecting consumers]
Must provide contact info for consumer complaints	Must maintain a 24/7, 365, Monday through Sunday "live" customer service helpline
Policies and programs that must be in place before able to APPLY for a license: • Anti-money laundering	Policies and programs that must be in place to APPLY for a license: • Anti-money laundering • Cybersecurity program • Business continuity plan • Operational security program • Antifraud program • Unregistered securities risk plan • Conflict of interest program
	• Note: specific topics within each that must be addressed
Must only disclose criminal CONVICTIONS in control person background check.	Must disclose all deferred prosecutions (i.e., even a diversion program when a juvenile where no conviction) and all convictions.
IDFPR can suspend or revoke license only FOR CAUSE based on violations of certain enumerated provisions. Party has 10 days to respond requesting a hearing in response.	Even if meet all application requirements, Secretary can unilaterally determine that the applicant "does not command the confidence of the community" and deny the application. Not entitled to a hearing

Application fee $2500 and applicant must cover the REASONABLE COST of the application investigation. AND Secretary may conduct an examination or investigation AS REASONABLY NECESSARY and IDFPR has the authority to impose and collect PROPORTIONAL AND EQUITABLE fees and costs associated with applications, examinations, investigations, and other actions required to achieve the purpose of this Act.	Application fee will be determined unilaterally by Secretary and applicant must cover the ENTIRE COST of the application investigation. AND IDFPR can investigate applicants or licensees AT ANY TIME, for any reason, AT THE SOLE EXPENSE OF the licensee/applicant.
If change in licensee's control persons/owners, must give notice and disclose info the secretary requires on the new control person and they can informally approve if they deem them fit	If a change in control/owner, business must formally reapply as if an entirely new business (incurring all the expense and burden of applying, investigations, etc.)
Agent of payee ("AoP") exemption available [if only accepting customer's payment on behalf of merchants before sending it on to the merchant (e.g., through a point of sale device or interface) no license required]	AoP exemption not available [effect = massive barrier for innovators trying to facilitate merchants accepting crypto payments]

Passing DARA in its current form, driven by a sense of urgency after the FTX collapse, would not prevent unscrupulous offshore custodial exchanges like FTX from operating in Illinois and increases the likelihood of consumer harm.

It is essential to recognize that DARA, similar federal and state legislative proposals, federal regulatory efforts, and general political will to regulate digital assets have been heavily influenced by the FTX collapse in November last year.
FTX did not fail because its business involved digital assets. It failed because FTX executives took custody of their customers' assets and used them for their own benefit at their customers' expense—moving them to their hedge fund Alameda to cover a shortfall that resulted from risky market bets. The harms resulting from FTX are not new; they happen repeatedly in traditional custodial financial arrangements and should not be used as justification to regulate the digital asset industry in a punitive manner.

FTX committed fraud by lying about how they would treat customers' funds once they were in FTX's custody. Custody relationships are heavily regulated whether they involve fiat, securities, or any other form of value for this exact reason.

Had FTX openly operated in the US, their custodial activities (i.e., the direct source of consumer harm) would have already subjected them to regulation by the IDFPR under the existing Transmitters of Money Act. FTX was able to deceive the public, not because US laws were inadequate, but because they were not subject to US law or supervision whatsoever because they intentionally located themselves outside of US jurisdiction. Passing punitive domestic regulations in response to their misdeeds punishes good-faith innovators operating in the US; It simultaneously advantages digital asset businesses that intentionally locate themselves offshore to avoid US law by eliminating potential US-based competitors.

Furthermore, DARA would not have prevented the consumer harm resulting from FTX's fraudulent practices had this regime been in place, and they sought licensure in IL before it occurred. FTX could have used its vast resources to develop exceptional policies and programs, meet all net worth and surety bond requirements (even in the millions of dollars), hire compliance and regulatory professionals, and lied about what they intended to do with the customer funds they custodied (just as they did to the customers themselves in their terms of service).

Rather than preventing another FTX, efforts like DARA make it more likely. Should this legislation spread to other states, it will be impossible for good-faith, early-stage innovators to legally pursue and develop their ideas without incurring prohibitively expensive upfront costs associated with licensure or risking six-figure civil penalties.

This legislation—and any like it elsewhere—will drive innovation completely offshore, with no US regulatory oversight yet virtually unlimited access to American consumers over the internet—the exact situation FTX took advantage of and were operating under when many of the same politicians now advocating for strict regulation took campaign contributions from FTX and proposed laws that would have benefitted those in FTX's position.

DARA is, at best, misguided and premature and, at worst, intentionally discriminates against a disfavored industry. It does nothing to keep fraudsters out of Illinois and protect the public. Instead, it covers almost every conceivable activity involving digital assets and weaponizes wealth minimums and severe civil penalties as barriers to entry to those activities.

By proposing DARA, Illinois has signaled an intent to join a deeply paternalistic and Orwellian approach to a novel technology; An approach designed to kill the technology in its infancy before the broader public has the opportunity to understand the advantages it offers over the status quo.

Should it pass DARA, Illinois will stifle innovation and economic productivity, hinder fair competition in favor of entrenched interests, and expose Illinois consumers to greater risk of

harm.

Recommendation

Amend the Transmitters of Money Act (TOMA) to cover digital asset *transmission* as a category of money transmission. This approach would: (1) subject FTX-like digital asset businesses that custody customers' assets to regulation designed to protect consumers from the harms that can result from that relationship; (2) avoid subjecting noncustodial digital asset businesses and innovators to unnecessary and prohibitively expensive licensing and regulation; and (3) avoid subjecting individual enthusiasts to massive civil penalties for personal interactions with digital assets as if they were an unlicensed for-profit business.