



The Latest in Money Transmitter Licensing

Thursday, February 19, 2015

Presented By the Bryan Cave Payments Team

Agenda

- Background (J. Rinearson)
- Recent changes in the laws themselves (R. White)
 - Scope of application of state laws
 - Multistate efforts; the NMLS system
 - “Agent of the payee” exemption
 - Other trends/changes in laws
- Changes in the treatment of authorized delegates (J. Crowder)
- Is it possible to comply without obtaining a license? (J. Crowder)
- Enforcement Actions (S. Iwarere)
- Treatment of Virtual Currencies/Bitcoin (J. Rinearson)
- Conclusion

Money Transmitter Licensing Laws

- Genesis: “Safety and soundness” of non-bank issuers
 - Banks are generally exempt
- Sometimes called “Sale of Checks” or “Money Services”
 - But not “deferred presentation” or “check cashing”
- Typically regulate non-bank entities that:
 - Receive and hold consumer funds, with promise of making funds available later or sending funds elsewhere; or
 - Issue or sell “payment instruments,” which include “stored value”
- 48 states have enacted MTL laws, which usually require:
 - Minimum capitalization (\$50,000 – \$1 million) and bonding
 - Background checks on principals
 - Holding 100% of consumer funds in “permissible investments”
 - Regular reports; annual renewal filings; fees; audits
 - No restrictions on other lines of business – thousands are licensed
- Difficult to get but still a valuable entry into financial services
 - Critical protection for consumers and the payment system
 - But do MTL laws stifle payment innovation?

Money Transmitter Licensing Laws

- Cost
 - Approx. 2 years and \$200,000; \$50,000+ in filing fees
 - Net worth requirement of \$50,000 – \$1 million
- Requirements
 - At least one full-time licensing employee
 - Full-time AML Compliance officer
 - Ongoing compliance, renewals, and fees
- Risks
 - Federal crime to operate as an unlicensed money transmitter
 - 18 USC § 1960
 - State penalties (\$10,000 – \$2 million)
 - Subject to audit and supervision

These laws allow Western Union, Moneygram, Paypal and Google to do payments business without a controlling banking partner.

Reed White

RECENT CHANGES TO LAWS & REGULATIONS

2014 Changes

- Two kinds of changes
 - Changes in the text of laws/regulations
 - Changes in interpretation (more troubling)
- 19* new bills/regulations impacting money transmitters passed in 2014
 - Significant updating (both technical and substantive) – 5 states
 - NMLS additions – 3 states
 - Agency changes/clarifications – 3 states
 - Fraud-related changes – 2 states
 - “Agent of the payee” exemptions – 2 states
 - Changes to fees – 3 states
 - Other changes – 3 states

** Some state laws impacted multiple areas, hence the list does not total to 19.*

Scope of Application of Laws

- Expanding scope of licensing laws
 - Whether by law or a change in interpretation
- Traditional analysis
 - “Receipt of funds” required
 - Holding funds in a “custodial account” = no ownership or control
- Evolving analysis
 - “Holding oneself out” as a money transmitter
 - “Advertising” or “soliciting” money transmitter services
 - Co-branding
 - Ability to “instruct” payment (regardless of custodial account)

National Multi-State Licensing System (NMLS)

- Created by Conference of State Bank Supervisors
- Originally for mortgage originators (SAFE Act)
 - Now used by multiple states to track money transmitter licenses
- Central repository for MTL applications and renewals
- Facilitates information sharing between member states
 - Some difficulties remain (e.g., updating personal records requires access to individuals' credit reports)

Agent of Payee Exemption

- A positive development
- Acknowledges the purpose of money transmitter laws is consumer protection
 - Intermediary (often a payment processor) contracts with a merchant/payee, thereby serving as the merchant's agent
 - Intermediary receives funds from customer on merchant's behalf
 - Once customer pays the intermediary, he/she is no longer liable if the intermediary fails to remit the funds to the merchant
 - Customer's payment to intermediary constitutes full and final payment
 - Dispute between intermediary and merchant is governed by contract
- To date, only 4 states provide a broad “agent of payee” exemption
 - California, Nevada, New York and Ohio

States Providing “Agent of Payee” Exemption



Other Legislative or Regulatory Changes

- Major re-writes: Often updating laws to align with Uniform Money Services Act
- Fraud-related: Disclosures aimed at protecting consumers using remittance companies to pay scammers (such as “lottery” scams)
- Fee-related: Increases to fees; changes to method of charging or assessing fees
- Record-retention: Expanding time period for holding transaction records
- Enforcement-related: Increasing rights to suspend licensees or increase penalties
- Technical re-writes: Changes to numbering, etc.

Jennifer Crowder

AUTHORIZED DELEGATES & BEING COMPLIANT WITHOUT GETTING LICENSED

Authorized Delegates

- Licensees are permitted to appoint Authorized Delegates
 - Duly appointed authorized delegate is not obligated to obtain its own license
- What is an authorized delegate? Laws are similar from state to state:
 - “Authorized delegate” means a person a licensee designates to provide money services **on behalf of the licensee**. (AR)
 - “Agent” means any person designated or appointed by the licensee pursuant to a written agency contract to engage in money transmission activities at locations other than a duly authorized office of the licensee as provided in section 648 of this article. (NY)
 - “Authorized delegate” means a person a license holder appoints under Section 151.402 to conduct money transmission **on behalf of the license holder** (TX)
 - A licensee may conduct **its business** through or by means of such agents as the licensee may designate or appoint. (VA)
 - “Authorized delegate” means a person a licensee designates to provide money services **on behalf of the licensee**. (WA)
(Emphasis added)

Changing Trends in the Role of Authorized Delegates

- Traditional: acted solely as a sales agent
- More recently expanded to other roles
 - Licensees appoint others to conduct a range of money transmission businesses
 - Mobile P2P payments; prepaid cards; bill payment
 - Entrepreneurs and start-ups that want to be compliant, but don't have resources to obtain licenses in 40+ states, obtain “secure payment services” from licensed money transmitters
- Licensees with a brick & mortar network add new services to their existing payment networks
 - Prepaid reload; bill payment; etc.

Growing Concern from Regulators

- Can a licensee appoint a third party as authorized delegate if the third party is offering a product or service that the licensee *does not already provide*?
 - Can the authorized delegate be said to be providing services “on behalf of” the licensee if the licensee is not already in that line of business?
 - Does such a relationship = “rent-a-license”?
- Or...can a licensee decide to offer a new service—such as prepaid card reloads or Person-to-Person mobile payments—and do so through a third party?
 - Where and how should the line be drawn?

Role of Authorized Delegates

From our perspective, impact of allowing Licensees more latitude to appoint authorized delegates who offer new products/services:

- Pros
 - Licensee is responsible & funds are fully protected
 - Provides an option to start-up businesses that want to be compliant
 - Encourages safe and secure innovation
 - Allows Licensees to recoup costs of maintaining licenses
- Cons
 - Could appear to be “rent-a-license”
 - Licensees may not fully appreciate the additional responsibilities arising out of these arrangements
 - Creates confusion for regulators/examiners
 - “Tail wagging dog”?

Some State Responses:

- Washington – A Licensee cannot appoint an authorized delegate in Washington if the authorized delegate does not have a physical location in Washington
- Texas – “Supervisory Memorandum” prohibits any authorized delegate relationship unless the authorized delegate is in the same business as the licensed money transmitter
- Virginia & Michigan – Licensees can only offer Prepaid Reload Services to their existing authorized delegate networks if the Prepaid Program managers contract directly with each location, since Reload services are not the Licensee’s business
- Informal advice that “trend is growing” among states

Another Approach

- Could states permit more latitude, thereby making payments safer while also keeping State regulators in control?
- Could authorized delegates provide a potential “safety valve,” thereby reducing calls for a national licensing program?
- If so, licensees would have to take significant responsibility
 - Conduct due diligence and criminal background checks
 - Review AML and anti-fraud compliance procedures
 - Monitor and report suspicious transactions
 - Report all authorized delegate relationships
 - Ensure that permissible investments and bonds cover authorized delegate transactions

Can a Payments Company be Compliant Without Licensing?

- 1) Structure so that product is not in scope
 - Don't hold funds in an account owned or controlled by the company
 - Don't issue or sell a payment instrument or prepaid card
- 2) Partner with a Bank by serving as the Bank's agent
 - But not all states exempt all types of banks
 - Some states exempt only national banks, not out-of-state state banks
- 3) Partner with a licensed money transmitter by serving as a licensee's authorized delegate
 - But note some states' scrutiny of unrelated delegate business
- 4) Where possible, serve as "agent of the payee"

For 2 or 3, company must disclose fully and cede significant control

Seyi Iwarere

ENFORCEMENT ACTIONS

Enforcement Actions Increasing

- Both in number of actions and amount of fines/penalties
- Pre-2005, penalties ranged from \$1,500 – \$50,000
- Now penalties can exceed \$500,000, with some reportedly equaling more than \$1 million
- Often no link to losses or actual criminal activity
- No need to prove intentional misconduct
- Penalty is seen as a necessary punishment and disincentive for other companies

Typical Enforcement Process

- State learns of possible violation—*often from a competitor*—and sends Inquiry or Demand Letter
- Company has 30 days to provide details of length of time doing business and volume of business in state
 - Or can provide legal basis as to why no violation exists
- State reviews materials, makes a determination and issues a Consent Order
- Negotiations proceed on wording of the Consent Order and amount and payment of fine/penalty
- Company signs Consent Order and pays penalty
 - Depending on state, Order may be publicly posted

Enforcement Often Targeted at Payment Innovations

- Illinois imposes Cease & Desist on:
 - Square
 - TouchPay
 - Skrill
 - Netspend
- Florida penalizes:
 - Square
 - Bill.com
- New Hampshire fines:
 - TouchPay
 - Qpay

Remember: State Regulators Talk to Each Other!

- Enforcement action in one state can mean action in another state may follow (e.g., Square, TouchPay)
- Good idea to know your regulator(s)
 - Money Transmitter Regulators Association (MTRA): [General Contact List for State Regulators](#)
 - MTRA Annual Conference: October 2015 (Kansas City, MO)
 - Website: www.mtraweb.org

Judie Rinearson

BITCOIN AND OTHER CRYPTO OR VIRTUAL CURRENCIES

Do State Money Transmitter Laws Apply to Crypto or Virtual Currencies?

- Many states say “Yes”
 - Coinbase is licensed in:
 - Alabama, Arkansas, Delaware, Georgia, Idaho, Iowa, Kansas, Maine, Mississippi, Nebraska, New Hampshire, New Jersey, North Carolina, North Dakota, Puerto Rico, Washington, and West Virginia
- Texas and others – waiting to see; not “money”
- New York – not yet, but soon pursuant to a pending special licensing law
- California – new virtual currency regulations pending

Potential Uniform Law Proposal by Conference of State Bank Supervisors (CSBS)

- Draft Model Regulatory Framework Includes
 - Licensing requirements with credentials for business owners and key personnel, including details on banking arrangements
 - Licensing systems that allow states to share data in real time
 - Financial strength and stability requirements, such as net worth and capital requirements, surety bonds, and disaster recovery plans
 - Consumer protections such as a reserve amount of virtual currency held in trust, insurance coverage, and public disclosure of licensing information
 - A cyber security program
 - BSA/AML compliance

Problems Applying State Licensing Laws to Virtual Currencies

- Net Worth – in what currency?
- Start-ups
- Permissible investments
- Bonding requirements
- Audit requirements
- AML requirements
- Authorized Delegates
- Conflicting approaches by state and federal regulators

Conclusions

- Dark Days for unlicensed emerging payments businesses
- Must pay attention to these laws – often overlooked
- Still a major cost and concern for small companies
- No “pass-porting” or similar mechanism
- Impact on US payment innovations: calls for a single federal license

Thank You!

For more information, please contact one of the speakers listed below.

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