Government Oversight of Non-Bank Financial institutions In the United States

Why Change is Urgently Needed

A White Paper Prepared by

The National Money Transmitters Association

David Landsman, Executive Director

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Businesses That Are Declared ‘Risky’

Money transmitters, check cashers and currency exchangers belong to a broad class of non-bank financial institution called *Money Services Businesses (MSBs).* The term ‘MSB’ includes money transmitters of various types. These industries are *perceived* as not being very well-regulated and, as a result, vulnerable to money laundering and financial fraud.

There are a few other important reasons money transmitters are considered high-risk, but by far, the reason most often cited for classifying money transmitters as “risky” is that they are “…subject to a patchwork quilt of state regulations,” to use the common phrase.

Banks are considered to be lower-risk because they are highly-regulated. Other types of financial institutions (all the non-banks) are somewhat less regulated, therefore, seen as high-risk. In the popular mind, no further distinctions need be made as to how well-regulated a particular money transmitter may be. All money transmitters have been declared “risky” and are treated as such.

Why have all money transmitters been declared “risky?” If indeed it is true that the degree of perceived risk is inversely proportionate to degree of regulation, then the lack of a uniform regulatory system must be to blame.

This paper will discuss how the high-risk designation came about, why the effects are bad, and suggest some ways these conditions might be improved.

Congress Abdicates Responsibility

The lack of a uniform system can arguably be traced to decisions Congress made in 1992, when they passed the Annunzio-Wylie Anti-Money Laundering Act.

Although money laundering is (and always has been) a national and international problem and the money transfer business, by definition, operates globally, although Congress was already growing wary of money transmitters, it was decided at that time to leave money transmitters without a primary regulator at the federal level.

Instead of setting up a national office to coordinate the various states’ regulatory efforts, Congress 1) ordered banks to report the identity of any and all money transmitters for whom they opened an account; civil penalties were to be imposed for any reporting violations,[i] and 2) made it a serious violation of US *federal* law to conduct an unlicensed money transmitting business in a state where that would be illegal by state law.

Two years later, in 1994, Congress instituted the Federal MSB registration requirement and made it an equally serious matter if you failed to register that business with FinCEN (the Financial Crimes Enforcement Network). [ii] The states were urged to make their laws more uniform, and to do so on their own initiative.

The fundamental contradiction remained unresolved: if money transmitters were as risky as they seemed, why was it not considered more important to do more to regulate them? If indeed it was important that money transmitters be regulated, didn’t that create an unfunded mandate for those states that cared to regulate, and a gaping hole in our regulatory system, in those states that did not?

A Contradiction of Jurisdictions

Confusion arises because the states differ widely on what activity requires a license. The answer varies from case to case, and very much depends on how state law treats the business model and type of activity in question, and how state banking authorities interpret that law.

Once a state decides what activities it wants to regulate, it has to decide whether to regulate providers that have no physical presence within its borders, but are located out-of-state. This aspect, too, changes over time.

For example, California and New York never used to require a license of companies that wished to do business with their residents by phone, mail or internet, as long as the provider had no physical presence in their state. This was what the DFI told anyone who asked; complaints about such unlicensed transmitters advertising in California went unheeded. In 2011, California changed its law and the New York Department of Banking legal counsel simply reinterpreted theirs. Today, they, and most other states, require licensure of providers with no physical presence, no matter where in the world that provider is located.

[A foreign transmitter could also be considered by some states, and by FinCEN, to need a license, if it merely has a US bank account used to execute or receive third-party payments, even though the transmitter does not solicit US customers.]

State legislatures continually enact new license requirements and amend the ones they have. Forty-seven states now regulate money transmission, but each one decides for itself how to define that term. In 2003, 44 states had 'sale of checks' laws, but only 30 regulated money transmission when no checks or money orders were involved. Today, New Mexico is the last state that regulates money orders but not money transmission.

Including Washington, DC and all the US territories, we have fifty-five licensing jurisdictions. There are many similarities among the various state laws, but supervisory regimes range widely in rigor, frequently overlap, and sometimes contradict each other. Coverage of prepaid debit cards, internet and mobile money transmission is still a very mixed bag. The only two states that lack any type of money transmitter regulation are Montana and South Carolina, and legislation has already been introduced in the latter.

Whether you are a single-state licensee in Hoboken looking to expand, or a mobile operator in Helsinki who has a next-generation money transfer app to offer US residents, this legal uncertainty will stymie your planning. The safest solution is to obtain a license in every state, or risk violating both state and federal law. Understandably, some people will just decide to find another market, or another line of work, thus, competition and innovation are reduced.

Money transmitters, who must have access to the banking system in order to function, have seen most banks close their accounts categorically, without any chance of appeal, because regulatory pressure makes banks treat their money transmitter customers with a presumption of guilt. The loss of these bank accounts is another way failure to regulate reduces competition and innovation.

Almost thirty states currently perform on-site examinations of money transmitters; there are many states that do an excellent job of supervision. Yet, perhaps now it is clear why money transmitters are seen as high-risk and under-regulated: because it is just too complicated – *even for the experts* – to know for sure who is supposed to be regulated by whom, who *is* being regulated by whom, how closely, by what standards and procedures, and for what type of activity.

The Case for Centralization

In contrast, it would surprise most Americans to learn that the European Union enjoys a more integrated payments market than the US. After years of cooperative effort, their *Payment Services Directive* allows providers to ‘passport’ their license from one country to another within the Single Euro Payments Area. This applies to physical locations as well as the rendering of services with no physical presence.

In Europe, reciprocal license recognition based on common standards encourages non-banks to enter the payments industry and enables competition across national boundaries. Standardized consumer protection laws keep a level playing field, and make sure more consumers are better protected.

A more centralized approach to regulation would do the same for us. Surely, what the Europeans have achieved among their nations through cooperation and planning, we should be able to emulate among our states, here at home. Our nation’s regulatory structure has turned into a huge barrier to competition. What began as a noble effort to protect consumers, has instead deprived them of the access, selection and lower prices that greater competition would have brought.

State regulators do their best to share information on licensees and cooperate on examinations and a few are starting to use the National Mortgage Licensing System to help keep better track of licensees across state lines. Yet, it is still impossible to find a simple list of all state-licensed money transmitters, because such a list simply does not exist.

The federal money transmitter registration requirement was supposed to create such a list, but FinCEN does not verify information submitted by the money transmitter, so the list has become hopelessly cluttered. For example, although money transmitter agents are not supposed to register, some 16,000 of the 37,000-odd money transmitter registrants today are listed as money transmitters when, in fact, there exist only roughly 600 state-licensed money transmitter principals in the United States.

FinCEN is called the ‘default’ federal regulator for all industries covered by the Bank Secrecy Act, that do not have a primary regulator on the federal level. But FinCEN only regulates for anti-money laundering (AML) compliance, not safety and soundness or consumer protection and does not regulate anyone directly. The job of examining money transmitters for AML compliance was delegated to a small force of IRS examiners working under FinCEN’s budget, and now FinCEN seeks to delegate even more of that job to the states.

US money transmitters must be more consistently regulated to protect consumers against deceptive practices and financial loss, to fight money laundering and all kinds of financial crime, to create and allow a robust environment that encourages competition and innovation instead of stifling it.

Money transfer regulation in the United States today is redundant and inconsistent on the state level, siloed and inadequate on the federal level. What we need is neither more nor less regulation. What we need is simpler, more consistent, more centralized regulation.

What we need is *better* regulation.

Toward the Orderly Banking of Money Transmitters

Not all financial services are performed by banks, nor should they be. As specialists, transmitters provide services that banks cannot deliver as efficiently, or do not offer at all. Remittances, money orders, prepaid access cards, virtual currencies, internet and mobile money transfer, all are forms of money transmission. What might seem like one industry is really a diverse, international *group* of industries, serving all kinds of customers, constantly increasing in size, importance and complexity.

Money transmitters are finding it difficult or impossible to get bank accounts because they lack credentials that banks might rely on. Most times, banks are unwilling to run the risk, and just close all their money transmitter accounts.[1]

Banks are expected by their regulators, to do the job of regulators, on money transmitters. Indeed, in a sense, their responsibility is greater than that of regulators, because the money actually flows through them.

Congress and regulators claim that they do not expect banks to be the *de facto* regulators of money transmitters, but the facts just do not bear them out. That is precisely what Congress wants, and that is precisely what banks cannot do. This is why money transmitter accounts are being closed and rejected.

If the lack of a more unified - and more uniform - regulatory system is the root cause of this problem, then we must directly address the way we regulate money transmitters. We can only start to discuss the credentials we need to get our bank accounts back, *after* we have simplified our regulatory system.

Conclusion

Good regulation facilitates legitimate commerce, lowers costs and promotes the smooth functioning of the financial system. In order to let companies operate freely while maintaining government control, we need more carrot now, and less stick.

Instead of criminalizing unsuspecting providers worldwide who may fail to get the right US licenses, instead of depriving consumers of a vital, dynamic market for money transfer services, let us give those providers who do wish to operate legally, a simpler, more reasonable path to obtaining the credentials we think they should have, and those banks who wish to bank them, a pathway to saying ‘yes.’

It is an ironic coincidence that the phrase ‘government oversight’ can be taken two ways, and that one meaning nullifies the other. It is ironic, also, when a government labels transmitters ‘risky’ for being ‘under-regulated,’ while overlooking its own responsibility to make sure appropriate regulation is in place, leaving the job primarily to the banks and the states.

Before money laundering was such a national concern, when the only way consumers sent money was at a local money transfer agent down at the corner store, perhaps it was OK to regulate transmitters at the state level, with no need for the federal government to get involved. But those days are long gone.

[1] Larger accounts are more likely to be seen by banks as worth the risk. Retail merchants are an important customer class for all neighborhood banks so, if the cash volume is not too high, they too have an easier time keeping their accounts.

We urge Congress, to immediately consolidate the oversight of money transmitters under a single central authority (preferably under FinCEN), that would coordinate and co-regulate with the states, the Consumer Financial Protection Bureau and self-regulatory organizations run by the money transmitter industries, themselves.

David Landsman is Executive Director of the National Money Transmitters Association. The opinions expressed are his own, and do not necessarily reflect the opinion of all members.

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[i] This reporting requirement was repealed two years later due, no doubt, to protests from the banking community.

[ii] Penalties include fines, forfeiture and prison. Even if you *unknowingly* break any state license law or fail to register with FinCEN (malum prohibitum), it is considered a federal money laundering offense and carries the same penalties you would face had you knowingly transmitted the proceeds of crime (malum in se). Without looking at willfulness or mens rea, without any advance warning required, ignorance of the law is treated as much more than a procedural infraction. Perhaps those finer distinctions was one of those liberties we sacrificed for greater security. That money transmission could be punishable as if the act itself were a crime, is an indicator of how fearful Congress is of non-bank money transmitters.