

Risky Business: State Regulation of Money Transmitters

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Introduction

Money transmission, a somewhat neglected financial activity from the state regulatory perspective, has been in the spotlight lately, particularly after September 11, 2001. Because money transmission is frequently conducted without attracting the scrutiny of financial examiners, it has been implicated in money laundering and other financial crimes. From somewhat humble beginnings as a service offered to individuals wishing to send money abroad, money transmission has grown into an international high profile business. It is essential for government regulators, whether or not involved in financial regulation, to understand the goals and challenges inherent in the regulation of money transmission.

Majority of States License Money Transmitters; Typical Requirements

Three-fifths of the states regulate or license money transmitters.^[1] Money transmitter license laws are typically enforced and administered by a state's department of financial institutions or banking department. The regulated activity, as defined in Arizona's law, is fairly consistent with the definitions found in other states' laws, i.e., "selling or issuing payment instruments, engaging in the business of receiving money for transmission or transmitting money, exchanging payment instruments or money into any form of money or payment instrument, or receiving money for obligors for the purpose of paying the obligor's bills, for compensation or in the expectation of compensation."^[2] The term "transmitting money" includes transmission by any means including transmission within the United States or to or from locations abroad by payment instrument, wire, facsimile, electronic transfer, courier or otherwise.^[3]

Common to most of the money transmitter laws is a requirement that the money transmitter maintain a state license, post a surety bond (ranging from \$25,000 to upwards of \$1 million), and maintain a specified level of net worth (ranging from \$5,000 to \$100,000 and usually a function of the number of offices or agents of the licensee). Less common is a requirement that a money transmitter maintain permissible investments with an aggregate market value not less than the aggregate amount of all its outstanding payment instruments.

Background. In a speech to the Money Transmitter Regulators Association^[4] Conference in San Diego, California in October 2002, California Commissioner of Financial Institutions Donald R. Meyer said that the money transmitter business began in California in the early 1900s because of immigrants wanting to send money to their native countries.^[5] California first licensed money transmitters in 1936. According to Meyer, transmitted funds originating from California in 2001 totaled nearly \$5 billion in more than 14 million transactions.

The focus on service to the immigrant community has not disappeared, even while money transmitters have broadened their appeal and the reach of their activities. In an article entitled “Money Wire Transfers: How to Help Immigrants Avoid Fraud and Save Money,” the National Consumer Law Center focuses on the risks to immigrants of using money transmission services. Principally, these risks include high fees and the possibility of fraud (*i.e.*, that the transmitted funds may never be received by the intended recipients).

Others have cited different reasons for the growth of the money transmission business. Addressing the National Conference of Commissioners on Uniform State Laws (NCCUSL) in 1997, Greg Gonzales of the Tennessee Department of Financial Institutions said that a failure of a regional money order issuer in the 1980s was the precipitating event for the growth of regulation of money transmitters.

Regardless of the cause for the increased attention and regulation, money transmission laws are here to stay and more such laws are likely to be adopted in the future. The most recent of the money transmitter acts adopted at the state level is Minnesota’s;^[6] Iowa may be the next to adopt a money transmitter statute, based on an announcement by Iowa Attorney General Tom Miller.^[7]

Current Issues Involving Money Transmission. In addition to the traditional role of money transmitters assisting people to send money to foreign countries, money transmission has found new outlets in the US. For consumer purposes, businesses like Pay Pal and Western Union’s Bid Pay have become popular. These services allow anyone with an internet address to send or receive money online. In the auction context, online payments have been hugely popular, because they save consumers money and time. The Nevada seller of merchandise on eBay, for example, does not have to wait for the Florida buyer’s check to arrive and clear, and can get paid right away even if he doesn’t accept credit cards.

For a long time, partly based on their novelty, these Internet-address payment providers assumed they were unregulated. As Pay Pal considered going public, however, questions were raised about whether it was violating money transmitter laws while unlicensed. Several states accused Pay Pal of engaging in unauthorized banking activities and still others required the company to obtain money transmitter licenses or cease doing business in the state.^[8] Pay Pal complied, and its website now lists 20 states in which it holds licenses. More recently, the same types of questions faced by Pay Pal have been posed to eBay’s Billpoint. Presumably, the regulatory scrutiny faced by Pay Pal and Billpoint is based on the same consumer protection concerns raised by the National Consumer Law Center, *i.e.*, avoiding high fees and possible fraud.

More timely and perhaps more significant from a regulatory standpoint is the possibility that money transmitters may facilitate criminal activity. The Department of the Treasury’s Financial Crimes Enforcement Network issued a “FinCEN Advisory” on the Black Market Peso Exchange system in 1999, reporting that money launderers are known to place funds by using non-bank money transmitters.^[9] The Advisory notes a recent upsurge in misuse of money transmission services by money launderers in transactions in which the laundered money funds peso-exchanges that fuel the narcotics trade. Apparently, money launderers are adopting the protective covering of legitimate transaction patterns, which makes them more difficult to spot. While the USA Patriot Act makes it a federal crime to operate a money transmission business without a license, federal regulators acknowledge that non-bank intermediaries in the financial system can avoid the attention of law enforcement. In an environment where violations can easily go undetected, state regulators point to scarcity of personnel and financial resources to pursue even suspected violations.

Some enforcement has taken place at the state level, however, although much of it appears ministerial. For example, the New York Banking Department publicized the suspension of state licenses of money transmitters believed to have violated federal currency transaction reporting requirements.^[10] Whether license revocation

and fines will be effective to prevent abuse of money transmission services is doubtful, however. If the money transmitter regulators lack resources and investigatory tools to uncover violations, the profitability associated with misuse of money transmission services will ensure that misdeeds continue.^[11]

Regulatory Challenges Ahead. Obvious challenges face state regulators where money transmitters are concerned. First, there are hundreds of money transmitters, some of which operate below the regulatory radar. Second, the state laws on money transmission are neither uniform nor universal. Adjacent states may determine that the same activity is permitted or prohibited. Other states are simply silent on the issue.

Money transmission has a long and successful history in the United States. It serves the needs of a dedicated public, ranging from workers sending money to their home countries to consumers buying and selling goods from each other on the popular Internet auction sites. The best of the money transmission companies have developed novel, efficient, high-tech methods of moving money from person to person (witness Pay Pal). In the context of money transmitter regulation where consumer funds are concerned, the appropriate regulatory role is manifestly clear-cut and limited: the public should be protected against unfair business practices, exorbitant fees, and fraudulent diversion or inadvertent loss of funds.

The appropriate regulatory environment is murkier, and the regulatory task more difficult, where national security is concerned. As our focus on homeland security has increased and greater attention is paid to how terrorists and criminals finance their activities, so does the need for investigatory officials to scrutinize apparently routine transactions. Doing so will require intensive coordination among the states and among state and federal government agencies. Substantial personnel, educational and financial resources will be required. Supervision of money transmission to prevent money laundering raises questions of privacy, complex accounting, and awareness of both federal regulations and current events. To deal effectively with these issues, the regulatory community will have to be more pro-active than passive.

Regulation of money transmission is no longer “business as usual” and the risk of laissez-faire regulation is a palpable risk to us all.

[1] The following states have laws requiring money transmitters to obtain state licenses: Arizona, California, Colorado, Connecticut, Delaware, District of Columbia, Florida, Idaho, Illinois, Indiana, Kansas, Louisiana, Maine, Maryland, Massachusetts, Minnesota, Nebraska, Nevada, New Jersey, New York, North Carolina, Oregon, Pennsylvania, Rhode Island, Tennessee, Texas, Vermont, Virginia, West Virginia.

[2] Ariz. Rev. Stat. §§ 6-1201, 6-1202.

[3] Some state money transmitter laws, including California’s and Massachusetts’s, cover only transmission of money abroad, not domestic money transmissions. See, for example, California Fin. Code §1800 *et seq.* and Mass. Gen. L. ch. 169 §1.

[4] The Money Transmitter Regulators Association (MTRA) is a national organization dedicated to the regulation of money transmitters and check sellers; its members include state regulators. MTRA has developed model money transmitter codes, interstate cooperation in regulatory activities, and an examiner school. MTRA developed a cooperative agreement by which state members can examine licensed money transmitters, sharing their findings with other members.

[5] Speech of Donald R. Meyer, "Transfer of Money Across National Borders," at the Money Transmitter Regulators Association Conference, La Jolla, California, October 7, 2002.

[6] See Minn. Ch. 148, Laws of 2001, enacting Minn. Stat. Ann. ch. 53B.

[7] Attorney General Tom Miller announced he would ask the Iowa legislature to adopt a money transmitter business law which would authorize the Banking Superintendent to regulate money transmitters, investigate the criminal backgrounds of licensees, and inspect records of the transactions of money transmitters. Miller said "there has been a huge growth nationwide in money transmitter businesses, and we believe some of them in Iowa may be to illegal enterprises."

[8] See "Louisiana Asks Pay Pal to Halt Service in State," by Troy Wolverton (c/net, news.com), February 11, 2002, and "Pay Pal's IPO Woes Continue," by Joanna Glasner (Wired News), February 12, 2002.

[9] "Black Market Peso Exchange Update," U.S. Department of the Treasury, Financial Crimes Enforcement Network, FinCEN Advisory No. 9 (June 1999).

[10] See July 10, 2000 Suspension Order and Notice of Hearing and Statement of Charges for revocation of license of Pan American Money Transfer, Inc.

[11] Violation of money transmitter licensing laws is typically a misdemeanor punishable by imprisonment, but a diligent search of the websites of the state regulatory agencies has not turned up recent instances of criminal prosecution for unlawful money transmission activities.