

Memorandum

To: Drafting Committee and Observers

From: Commissioner Tom Bolt, *Chair*
Commissioner Anita Ramasastry, *National Conference Reporter*
Committee for the Revision and Expansion of the Uniform Money Services Act

Re: Revisions to Uniform Money Services Act

Date: March 3, 2004

At the 2002 Annual Meeting of the National Conference of Commissioners on Uniform State Laws (NCCUSL), the Committee on Scope and Program requested that the Study Committee on Revisions to the Uniform Money Services Act (“Study Committee”) explore the possibility of amending the Uniform Money Services Act (UMSA) in light of possible anti-terrorism measures suggested by the federal Office of Homeland Security (OHS).¹

The Study Committee was also directed to consider revisions in light of the enactment of the federal USA Patriot Act, which expanded the definition of money transmission to include “hawala” or underground banking. In January 2004, the NCCUSL’s Executive Committee reconstituted the drafting committee (“Drafting Committee”) for the amendment of UMSA.

I. Relationship between UMSA and federal Anti-Terrorism/Anti-Money Laundering Initiatives

The USA Patriot Act links federal anti-terrorism initiatives focused on non-bank financial service providers (referred to as money services) and state licensing and regulation of these same entities. The USA Patriot Act was designed to address a number of problems, not the least of which is the transfer of money using mechanisms and entities beyond competent government oversight or control. These changes significantly impact the estimated 5,000 to 8,000 largely unregulated money services businesses (MSBs) that wire money, cash checks, exchange currency, or sell and redeem money orders and log some \$200 billion in yearly transactions.

¹ The Office of Homeland Security has been converted into a federal agency, the Department of Homeland Security.

As early as 1991, the U.S. Treasury identified MSBs as vehicles for money laundering. Investigations surrounding the September 11th attacks indicate that suspected hijackers made use of money orders and check cashing services. Reports indicate that around July, Mohamed Atta bought money orders from a small package shipping company in Florida, and that he used another MSB to send money to Pakistan days before the attacks. And in August, Zacarias Moussaoui, who some allege may have been the 20th hijacker in the September 11th attacks, received two wire transfers totaling \$15,000 sent from MSB outlets in Germany to an MSB outlet in Oklahoma.

While federal law requires MSBs to register and submit currency transaction reports (CTR's) and suspicious activity reports (SAR's) in the same manner as financial institutions, the federal government does not directly regulate these entities. The USA Patriot Act now makes it a federal crime for any person to operate a money transmission business in violation of state law, whether or not that person knew state law applied.

State governments are the primary front-line regulators of MSBs, by means of state licensing laws, which can vary greatly from jurisdiction to jurisdiction.

In 2000, the Uniform Money Services Act ("UMSA"), now available for enactment in all the states, was approved by NCCUSL following a request from the Financial Crimes Enforcement Network (FinCEN) offices of the U.S. Treasury. The Act's licensing requirements strengthen states' abilities to prevent and detect money laundering.

In July 2002, the Executive released a national OHS strategy plan. As part of the plan, the OHS called for renewed state initiatives in an effort to prevent the use of unregulated financial services for terrorist financing.² In this regard, the report made reference to the Money Laundering Suppression Act (P.L. 103-325) of 1994, which urged states to enact uniform laws to license and regulate money services. The report further called on states to "assess the current status of their regulations regarding non-depository providers of financial services and work to adopt uniform laws as necessary to ensure more efficient and effective regulation. By doing so, states would protect consumers by providing increased stability and transparency to an industry prone to abuse while at the same time providing state and local law enforcement with the tools necessary to dismantle informal and unlicensed money transmission networks."³

II. Possible Revisions to UMSA Relating to Federal Anti-terrorism Initiatives

² National Strategy for Homeland Security located at <http://www.whitehouse.gov/homeland/book/index.html>.

³ Id. See <http://www.whitehouse.gov/homeland/book/sect4.pdf>

A. Revisions of UMSA definitions and licensing requirements to include informal value transfer systems such as hawala banking

Section 359 of the USA Patriot Act amends the definition of financial institution to include so-called informal value transfer systems (“IVTS”).⁴ Section 359 subjects IVTS to the mandatory records and reports requirements of the federal Bank Secrecy Act. IVTS are described as persons who engage as a business in the transmission of funds, including through an informal value transfer banking system or network (e.g., hawala) of people facilitating the transfer of money domestically or internationally outside of the conventional financial institutions system.

In 2002, The U.S. Department of Treasury conducted a study of IVTS and the need for regulation, in light of the events of September 11th.⁵ FinCEN noted:

While it appears that the majority of IVTS activity is legitimate in purpose, these systems have been used to facilitate the financing of terrorism and in furtherance of criminal activities. For this reason, many governments have begun to look at this issue in terms of the need for regulatory and legal controls and in terms of their ability to conduct successful financial investigations in cases where IVTS has been used

Treasury concluded that existing federal laws and regulations were sufficient to deal with IVTS and emphasized the need for the federal government to focus on compliance and enforcement efforts.⁶

At present, UMSA may, by implication, cover informal value transfer systems (“IVTS”) within its scope. Further refinements to the UMSA definition of money transmission, however, will make it clear that the scope of the licensing provisions include hawala systems as well as

⁴ “IVTS include informal or unconventional entities operating outside of the mainstream financial system, such as hawala, hundi, fei ch’ien, hoe kuan, hui k’aun, and many others. Historically, these informal entities have been labeled by various terms including “alternative remittance systems,” “underground banks,” and “informal value transfer systems.” A Report to the Congress in Accordance with Section 359 of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA PATRIOT ACT) submitted by the Secretary of the U.S. Department of the Treasury November 2002

⁵ Id.

⁶ As Treasury noted: “Based on what we know so far, we appear to have the legislative and regulatory tools that we need. The primary problems are those of compliance, enforcement, education, and cooperation. Treasury accordingly recommends that U.S. efforts be focused on these areas, beginning with the effort to bring all money transmitters, IVTS or otherwise, into compliance with the existing regulatory regime.” Section 359 Report, *supra* note 2.

other informal value transfer systems. The proposed revisions to UMSA include a new definition (Section 102(8)), adapted from the USA Patriot Act, to explicitly include IVTS within the statute's licensing regime. The definition of money transmission (Section 102(14)) has also been revised to include informal value transfer.

B. Inclusion of specific new anti-money laundering measures recommended by the Department of Homeland Security

In 2002, the OHS proposed a series of anti-terrorism amendments that were incorporated into draft legislation in New York designed to amend New York's money transmitter licensing laws. The New York legislation was ultimately not enacted. NCCUSL would need further guidance from observers, and DHS as to whether the New York amendments and any other new amendments would be suitable for uniform enactment by the States.

The New York legislation proposed the following:

- Required the fingerprinting and criminal history checks for money transmitters and license applications.

The proposed amendments to UMSA include two new sections on fingerprinting. Section 204 deals with fingerprinting of money transmitter licensees/applicants and Section 504 deals with fingerprinting of authorized delegates and subdelegates. There are exemptions for corporations whose shares are publicly traded, as a way of carving out larger listed entities from this requirement. The Committee will need to deliberate the merits of such a requirement carefully as there is some contention over the requirement of fingerprinting of individuals.

- Included a new sanction that would remove or prohibit certain persons from participating in the financial services industry (if they committed a predicate offense when engaged in money transmission).

The proposed UMSA amendments include a new Section 808, which is a modified version of the proposed New York legislation. It authorizes the relevant regulator to initiate administrative proceedings to remove or prohibit management and certain other key individuals such as controlling persons, and persons with specific contractual relationships from continuing to work with the licensee and also within the industry generally.

- Defined agents and subagents of money transmitters and established qualifications for the agents; prohibited the use of subagents by licensees;

UMSA already deals with "authorized delegates" of the licensee. The term "authorized delegate" was used in lieu of the term "agent" due to the contractual nature of the relationship between licensees and independent sales outlets that work on behalf of a licensee. The proposed amendments include bracketed sections and a definition dealing with subdelegates in the event

that the Drafting Committee feels it is useful to give regulators the ability to enforce UMSA at the level of the subdelegate. This might be a means of preventing criminal activity or safety and soundness problems at an even deeper level.

A new definition of subdelegate has been added and bracketed (See Section 102(22)). Section 503 outlines the contractual relationship between a subdelegate and a licensee (pursuant to a contract executed between an authorized delegate and a subdelegate that is approved by the licensee). Section 504 is a new provision that would allow states to request fingerprints and criminal history checks for authorized delegates and subdelegates.

Article 8 has also been revised such that enforcement actions that may be taken against authored delegates may also be taken against subdelegates as well.

The Committee will need to deliberate on whether to include provisions that reach as far as subdelegates and which require possible fingerprinting of authorized delegates and subdelegates. Large licensees will have significant numbers of delegates and as such fingerprinting may not be manageable when there is a large volume of delegates providing services to a licensee. Possible limitations may be to fingerprint only the principals of such delegates. At the same time, it will be very important to carve out an exception for delegates that are publicly traded corporations other business entities that are already subject to a high deal of scrutiny and regulation.

- Clarified the definition of illegal money transmission; and

UMSA already deals with illegal money transmission in that it is a violation of the Act pursuant to Section 807 to engage in money services activity for which a license is required, in the absence of a license.

- Increased penalties for certain activities by licensed and unlicensed money transmitters.

A new paragraph has been added to Section 806 (criminal penalties), which specifically lists a new crime relating to a person receiving money for transmission or selling payment instruments with the knowledge that the money being provided is derived from criminal activity. This is based on a proposed amendment to New York state money transmission law. In New York, proposed legislation also included increased civil penalties of \$500 per day rather than \$100 per day for failure to file required reports.

III. Amendments to the act to recognize balance need to license specific ethnic funds transfer systems with smaller size and limited geographic scope of such entities

After September 11th, there has been greater impetus to license ethnic money transmitters as well as entities that provide informal value transfer services within a particular ethnic community. Typically, these entities are smaller in size than major money transmitters, and often offer transfer services with a limited geographic scope (e.g., one or several countries only). There has been some concern at the state level, that traditional licensing requirements such as insurance and bonding requirements, may put some of these entities out of business if they were forced to adhere to the same standards as large publicly held companies that have a larger share of the money transmission market.

In addition to the OHS/New York amendments, the Drafting Committee might consider amendments to UMSA that would provide certain exemptions for smaller money transmitters serving a limited geographic area or ethnic community and sending funds only to one or a limited number of jurisdictions (e.g., Somalia). These exemptions might provide for a lower bonding requirement in order to permit the businesses to continue to provide vital services to ethnic or immigrant populations who need to send funds to their families overseas. Washington state, for example, has lowered the bond requirement for Somali money transmitters who engage in money transmission only to Somalia. This requirement, however, was not achieved by statute, but rather through the discretionary power of the regulator with respect to licensing and bonding.

IV. Possible revisions to create home state licensing regime for Internet payments providers

UMSA also includes certain types of Internet or electronic payment providers within its scope. To the extent that DHS and FinCEN have a continued interest in the Internet as a possible vehicle for money laundering and transmission of terrorist funds, UMSA provides one vehicle for addressing this issue. Many Internet funds transfer companies, however, have balked at having to obtain licenses (and thus obtain bonds) in 56 jurisdictions (50 States, D.C. and 5 U.S. insular territories), given that such entities do not have physical presence in these jurisdictions. Hence, at various times, such entities have mentioned the principle of a reciprocal licensing regime (using a home state/host state model of regulation). New Sections 203 and 204 have been added to UMSA, which propose a home state-host state reciprocal licensing regime for entities that wish to engage in business in multiple jurisdictions, but do not have physical locations in those states or territories.

V. Additional Internet related provisions

In a letter dated February 10, 2004, from Ayman Rizkalla, Associate Legal Advisor, U.S. Customs and Immigration Enforcement (“CIE”) of the DHS, to Chairman Tom Bolt, three additional issues relating to Internet payments were mentioned as possible topics for amendments. The ICE Cyber Crimes Center suggested the topics. The suggested topics include:

- Identifying the users/customers and transactions taking place on the Internet

A new paragraph (d) has been added to Section 201 (application for money transmission license), which requires the licensee to specify the verification procedures it will use to ascertain the identity of its online customers. This could be further refined to specify that the superintendent can require certain verification procedures for online transactions by rule. The commentary to UMSA can be revised to suggest appropriate methods of customer verification. Such methods or best practices for verification will, of course, change over time. Thus, the commentary can allude to what constitutes best practice at present.

- Payment Systems Used or Based on Other Currency or Commodities

UMSA already covers payments in other currencies and commodities including gold and scrip or value that constitutes monetary value.

- The proper tracking and record of online transactions

A new paragraph has been added to Section 605 requiring a licensee to maintain a record of the Internet protocol (IP) address for online transactions.