MEMORANDUM

To: Drafting Committee, Proposed Nondepository Providers of Financial Services Act
National Conference of Commissioners on Uniform State Laws
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Arthur E. Bonfield (Iowa)
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From: Anita Ramasastry, Reporter

Date: October 13, 1997

Re: Overview of Relevant Legislation and Regulations

This memo provides an overview of current federal and state legislation and regulations concerning nondepository providers of financial services ("NDPs"). This memo and its appendices are meant to aid the drafting committee ("Drafting Committee") in its consideration of the substantive framework of the Proposed Act on NDPs (Proposed Act"). The term NDP has been used typically to refer to check cashers, check sellers, funds transfer agencies and currency exchange businesses. This memo, however, will also address the current regulatory framework concerning stored value and electronic currency providers in the event that the Drafting Committee chooses to include these new payment systems within the scope of the Proposed Act.

Specifically, the memo provides an analysis of the following:

- basic features of existing state legislation and regulations concerning NDPs;
- proposed federal regulations governing NDPs drafted by the U.S. Department of Treasury's Financial Crimes Enforcement Network ("FinCEN");
- a summary of current legal issues relating to stored value cards and electronic currency systems and potential regulatory responses.

For general background on NDPs and money laundering, please refer to the Drafting Committee s Memorandum of January 13, 1997 to the Executive Council on the Proposed Act, included as Appendix A to this memo.

Congress and the Federal government view the need for regulation of NDPs from a money laundering deterrence perspective. It is believed that the increased emphasis on recordkeeping and reporting requirements for depository financial institutions (e.g., commercial banks) has compelled money launderers to use NDPs as an alternative vehicle for moving illegal funds into the stream of commerce.

In 1994, Congress enacted the Money Laundering Suppression Act (MLSA) (P.L. 103-225). The MLSA recommended that the States enact uniform laws to regulate NDPs. MLSA urges states to enact uniform laws to license and regulate NDPs including businesses which provide check cashing, currency exchange or money transmitting or remittance services, or issue or redeem money orders, travelers checks and other similar instruments. Congress specifically requested that the States should develop uniform legislation under the auspices of the National Conference of Commissioners on Uniform State Laws (Conference) or the American Law Institute. Congress recommended that a proposed uniform act would include:

(1) licensing requirements for NDPs;

(2) licensing standards for NDPs that focus on:

  (a) the business records and capital adequacy of the NDP;

  (b) the competence and experience of the directors and officers of the NDP;

(3) reporting requirements concerning disclosure of fees for services offered to consumers;

(4) procedures to ensure compliance with federal currency transaction reporting requirements; and

(5) criminal penalties for the operation of an NDP business without a license.

Section 407 of the MLSA also calls for the States to enact civil or criminal penalties for NDPs who fail to comply with currency reporting requirements of the federal Bank Secrecy Act ("BSA"). Pursuant to the BSA, all financial institutions are required to report currency transactions equal to or greater than $10,000 to Treasury. For example, if a customer deposits $10,000 into his or her bank account, a financial institution must complete what is referred to as a currency transaction report ("CTR").

Federal and state regulators rely on CTR filings as a means of detecting money laundering. A CTR indicates the name of the depositor as well as the nature of the transaction. NDPs are technically required to file CTRs. The lack of federal and state oversight and regulation of NDPs, however, makes it difficult to enforce this reporting

requirement. Some NDPs may be unaware that they possess such an affirmative obligation.

Depository institutions ("DIs") are also required to fill out suspicious activity reports ("SARs") for financial transactions that have attributes of an illegal or fraudulent transaction (including money laundering). NDPs are currently not obligated to complete SARs. Treasury has recently proposed an SAR form for NDPs. Consequently, a customer may conduct transactions through NDPs that would normally be identified as a suspicious activity and reported to Treasury if conducted through a DI. For example, a customer who wires a large number of money transfers to a foreign country might remain undetected if he or she transacts with an NDP. By contrast, the customer would ordinarily find that the same transaction would be reported to Treasury by a DI. Congress hopes that uniform legislation in tandem with new Treasury regulations for NDPs will serve to prevent the use of NDPs as vehicles for money laundering.

II. Basic Features of Existing State Legislation and Regulations

For a comprehensive overview of current state legislation and regulation of NDPs, we have prepared a set of summary tables that are attached as Appendix B to this memorandum. Additionally, Appendix C includes an overview of state regulation prepared by the Florida Comptroller s Office.

A. Definition of NDPs and Scope of State Legislation

State regulation has typically encompassed the following types of NDPs: check cashers, check sellers,[1] currency exchange houses and money transmitters (wire transfer agencies). States may have legislation dealing with one or several of these businesses. The term "money transmitter" is often utilized in state legislation to refer collectively to check sellers and wire transfer agencies. In the past few years, stored-value providers have started conducting business in the United States. These companies have not been included in state legislation related to NDPs. Typically, licensing and regulation of NDPs is the responsibility of state banking departments.

The four major types of activity that are regulated are:

- check issuing or selling;
- check cashing;
- funds transmission; and
- foreign currency exchange.

[1] The term check seller encompasses businesses that sell many types of payment instruments including but not limited to travelers checks and money orders.

1. Check Selling

Check selling is the activity most heavily regulated by states. Fewer states regulate check cashing or funds transfer. Still fewer regulate foreign currency exchange. At present, approximately 42 states have some form of legislation that regulates the conduct of check sellers. Check selling includes the sale of money orders and travelers checks . Check sellers are often required to have licenses. Some states require that the check seller have a minimum net worth. Other states also require evidence of good moral character from the principals of the corporation and a business plan. States typically require bonds of between $10,000 and $3 million. California, however, does not require a bond.

Most check sellers are required to provide the name and address of each authorized vendor or agent and a consolidated financial statement (on a periodic basis) to a state regulator. Some states require that the licensed check seller enter into written contracts with its agents. Agents are not required, however, to have separate licenses. The licensee is then required to notify the state when it appoints or terminates an agent within a reasonable time after the event occurs.

2. Check Cashing

Far fewer states regulate the check cashing industry. Approximately 20 states currently have specific check cashing legislation. Check cashers are often licensed but are subject to less oversight than check sellers. This is due, in part, to the perception that check selling poses a greater risk to consumers that check cashing. Check cashers also offer services such as wire transfers or the sale of money orders. Thus, check cashers are often subject to some regulation by virtue of additional services which they provide. Bonding and net worth requirements are typically less stringent for check cashers. These businesses are also examined less frequently (if at all) by the state banking authority or other supervisory body.

3. Funds Transfer Agencies

To date, approximately 28 states have some form of legislation regulating funds transfer agencies. The majority of these states regulate check sellers and wire transfer agencies together under comprehensive money transmitters laws and regulations. For example, Louisiana, Arizona, Nevada and Kansas have money transmitter laws that regulate check sellers and funds transfer agencies together. California and Massachusetts have separate laws governing the provision of funds transfers abroad. Incorporated telegraph offices are typically exempt from regulation. The State of New York is the only jurisdiction to have a dedicated insurance fund created to guarantee New York issued payment instruments.

4. Currency Exchange

Currency exchange businesses are the least regulated. Only seven jurisdictions regulate currency exchange. Texas has dedicated legislation concerning currency exchange. Under the Texas Currency Exchange Act, it is a felony to operate a currency exchange without a license. The penalties include forfeiture of the business and all of its assets for a violation of the act. Retailers or wholesalers who accept foreign exchange as payment for goods or services provided are typically exempt from regulation.

B. Common Elements of State NDP Regulation

1. Licensing and Registration of NDPs

One of the first issues that the Drafting Committee will need to consider is the scope of the Proposed Act with respect to the types of NDPs to be included in the definition of NDPs. Additionally, the committee will need to evaluate to what extent a system of registration and licensing is desirable. Congress, in the MLSA, encouraged states to adopt uniform legislation governing the licensing and regulation of NDPs. Licensing can play a crucial role in money laundering prevention. Proper licensing mechanisms help states to detect illegimtate NDP operations and also discourages certain entities from conducting business. Licensing also provides an opportunity for states to monitor the ongoing operations of these businesses.

The Drafting Committee should also keep in mind the potential implementation problems that maybe created by licensing requirements. State banking departments have frequently been invested with NDP oversight. To the extent that the Proposed Act incorporates a uniform licensing scheme, these bodies will have increased responsibilities with respect to NDP supervision. This responsibility will potentially create increased fiscal and administrative burdens for these jurisdictions.

The committee might consider whether a broad licensing regime is necessary (that would include ongoing supervision of NDPs) or whether a registration and mandatory disclosure system would be preferable. The Proposed Act might require NDPs to register and to file information with respective state regulators. Simultaneously, the act could contain penalty provisions for the filing of false or inaccurate information.

States that currently regulate some (if not all) categories of NDPs require at a minimum that regulated NDPs register with an appropriate supervisory body. Most legislation, in fact, includes a licensing regime. To the extent that licensing is pursued as part of the Proposed Act, the Drafting Committee will need to consider what types of qualifications applicants should have and also what information should be furnished in the licensing process.

Florida has one comprehensive act governing NDPs. Within the act, however, are different registration and licensing standards for funds transmitters/check sellers as distinguished from check cashing and foreign currency exchange houses. Thus, the Drafting Committee might consider this as a possible approach to dealing with the differences in each of the businesses.

In addition to deciding the definition of NDP, the Drafting Committee may also want to consider which financial institutions should be explicitly exempt from the Proposed Act. For example, many states exempt commercial banks from regulation under a check selling statute. The United States Post Office is also exempt from check selling and money transmitter statutes. Additionally, the issue of whether authorized agents or vendors must

obtain individual licenses should also be considered. Typically, states do not require agents to obtain separate licenses or permission to transact business.

States often ask for the following type of information from NDPs that are seeking a license:

- history of material litigation or criminal convictions (for the NDP, its management and majority shareholders);
- employment history for management and controlling shareholders;
- a description of the activities conducted by the NDP;
- a list of the NDP's authorized agents and their locations; and
- financial statements

2. Role of Agents or Vendors

Typically, vendors acting on behalf of a licensed NDPs are not required to obtain a separate license. Licensees are often required to provide a periodic list of their agents to the relevant supervisory agency. The control of vendor or agent activity is left almost entirely in the hands of the licensee. A few jurisdictions require that an NDP provide sample agreements between the licensee and its agents as part of the license application. The responsibilities of the licensee with respect to agents, and the duties and liability of agents are issues that could be further expanded in the Proposed Act.

For example, as discussed below, Treasury has recently discovered that certain agents of licensed funds transmitters in New York City have actually assisted individuals to move illicit funds outside of the United States. Enhanced recordkeeping and reporting requirements for agents may help to deter this type of conduct.

3. Bonding, Collateral and Net Worth Requirements

As stated above, and as outlined in Appendix B, NDPs are typically required to be bonded and also in many cases to have a certain minimum net worth in order to operate in a given jurisdiction. The Drafting Committee needs to consider whether it should require regulated NDPs to possess a security device such as a bond or collateral deposit. In addition, consideration should be given to whether net worth requirements are also desirable as a safety and soundness measure. Another safety and soundness measure contained in a significant number of state laws is a restriction on permissible investments.

4. Examination of NDPs

States have typically vested their banking departments or other agencies with the authority to examine NDPs on a periodic basis. Many states, however, have not exercised this authority. Appendix C to this memorandum contains a summary of the current examination policies in each state as well as an indication of how frequently each state has examined various types of NDPs. As an alternative to regularly scheduled examinations, some states permit the commissioner of banking or other official to examine the books and records of an NDP as needed.

One of the primary reasons for the lack of NDP examinations is lack of personnel and financial resources. Consequently, several states have actually conducted joint examinations with regulators from other states. Tennessee, for example, provides for joint examinations with other regulators. California will accept an examination report from another state that has regulatory jurisdiction over a check seller. North Carolina will also accept examination reports compiled by money transmitter regulators from other states. In Oklahoma, the Commissioner may accept an audit performed by a CPA in lieu of an examination. The examination must be equal in scope to that performed by the state. New York's money transmitter and check cashing regulations include provisions whereby examinations include a review for compliance with the federal BSA.

Examinations are one way in which state regulators can detect and prevent money laundering. Consequently, the Drafting Committee may want to carefully consider the inclusion of some form of examination, inspection or audit procedures in the Proposed Act. If joint examinations are contemplated, issues of confidentiality among regulators needs to be addressed (with respect to information sharing). Furthermore, the issue of who should bear the costs of examinations should also be considered.

5. Recordkeeping

At present, NDPs are not uniformly required to maintain adequate records. This can hinder law enforcement investigations. The Drafting Committee needs to consider what types of records might be maintained by NDPs and also the duration for which they should be retained. Some states do not mandate a minimum period for record retention. The states that do have a requirement typically require an NDP to maintain its records for two or three years. An NDP may be asked to retain the following:

- a daily ledger of payment instruments sold and funds transmitted;
- a general ledger of assets and liabilities income and expenses etc.;
- settlement sheets from agents;
- a list of names and addresses of each agent as well as supporting documentation;
- statements or records from financial institutions which the NDP utilizes.

Funds transfer agencies and check sellers are often required to maintain more

extensive records than check cashers or currency exchange houses. This relates to the perception that the transmission of funds and the issuing of easily negotiable payment instruments (such as money orders) are the primary vehicles for money laundering (as compared with the encashment of checks or the exchange of foreign currency).

6. Reporting Requirements

The majority of states do not require NDPs to comply with federal or state money laundering regulations. Arizona and Illinois are examples of states that require NDPs to comply with federal money laundering laws. The Drafting Committee should consider to what extent NDPs should be required to comply with federal and state money laundering laws. The Proposed Act may simultaneously impose civil or criminal penalties for non-compliance with federal of state law.

State laws typically replicate the federal law and require that cash transactions in excess of $10,000 be reported to a state authority as well as to Treasury. Most of the state reporting legislation does not specifically address NDPs (but may apply to NDPs by implication). Several states including Colorado, Connecticut, Idaho, Indiana and Oklahoma require financial institutions to file SARs concurrently with federal and state authorities. Arizona has its own suspicious activity form for financial institutions. Suspected money laundering activities are reported to Arizona's Attorney General on a one page form.

Treasury and FinCEN have recently proposed certain regulations that will require certain NDPs (primarily check sellers and funds transfer agencies) to file SARs and also to keep track of funds transfers overseas. The Drafting Committee might consider whether the Proposed Act should include a parallel CTR or SAR reporting system at the state level. The committee could asses the unique characteristics of NDP financial transactions and also the type of NDP customer conduct that could be deemed "suspicious".

Most states require NDPs to submit or file annual or periodic financial statements with the appropriate regulator. Larger NDPs are often required to file audited and consolidated statements whereas smaller institutions may be excused from these requirements. Additionally, states sometimes require an NDP to notify the banking department or other regulator in the event that a "significant event" occurs. DIs are similarly asked to notify regulators if such an event occurs. This allows regulators to keep closer track of NDPs on an ongoing basis. Significant events may include:

- filing for bankruptcy commencement of any federal suspension or revocation proceeding;

- felony indictments relating to the NDP services (includes indictment of agents, employees and other affiliated parties, etc.); and

- a suspected criminal act perpetrated by a third party against an NDP or one of its

authorized agents.

7. Enforcement Guidelines

The appropriate regulator is typically given enforcement power in order to enforce NDP legislation. In a significant number of the statutes, a banking commissioner or superintendent is vested with the power to issue a cease and desist order against an NDP. Other disciplinary powers include the ability to: (i) institute administrative proceedings, (ii) revoke an NDP's licenses and (iii) issue civil fines or penalties. In California, for example, the Commissioner of the Department of Financial Institutions may issue cease and desist orders, removal or suspend or revoke a license pursuant to its statutory provisions on traveler's checks. Violations of the law that might trigger enforcement proceedings in many states include:

- knowing failure to comply with any provision of law;
- fraud, misrepresentation deceit or gross negligence in any transaction involving a money transmission;
- fraudulent misrepresentation, circumvention or concealment of any matter required to be stated or furnished to a customer;
- failure to maintain, reserve and keep available books and records for examination;
- willful obstruction or refusal to allow examiner to inspect NDP s books and records;
- operating in an unsafe or unsound manner;
- making a material misstatement of fact in initial licensing application or any subsequent filings; and
- having been convicted of or plead guilty to a crime

8. Civil or Criminal Penalties

Violations of NDP laws are felonies in some states and misdemeanors in others. Civil money penalties may range from $100 to $500 per day in some states, up to $1,000 per day in others. Several states have even higher civil money penalties. In the State of Indiana, for example, violations of the money transmitter law may bring a penalty of up to $50,000 for each violation. Congress, in the MLSA, suggested the use of criminal penalties for violations of NDP statutes or related money laundering statutes perhaps because money laundering is itself a criminal offense. Civil penalties, however, may be preferable because the Proposed Act is a commercial law that may be primarily enforced by an administrative agency rather than civil law enforcement authorities.

III. Model Act from the Money Transmitters Regulators Association

The Money Transmitters Regulators Association[2] (MTRA) has developed a model act (the MTRA Act) that deals with the licensing and regulation of money transmitters. The MTRA Act is included as Appendix D to this memo. To date, [number] institutions have adopted the model act in some form. The MTRA describes its model act as a safety and soundness" law. The MTRA has offered to work with the Drafting Committee and to provide guidance concerning its model act.

The MTRA Act provides a useful frame of reference, but does not encompass all NDPs. Check cashers and currency exchange operations are specifically excluded from its scope. The MTRA Act does not deal with reporting requirements or enforcement mechanisms aimed at money laundering detection or prevention. The MTRA Act may serve as a useful starting point for the Drafting Committee' discussions. If the Drafting Committee decides to include licensing and regulation of NDPs generally as part of the Proposed Act, the MTRA Act may provide a basis for expanded uniform legislation that would include check cashers and currency exchange houses.

IV. Proposed Federal Regulations Governing NDPs

The MLSA stated that NDPs should be required to register with the Secretary of the Treasury. The purpose of the registration requirement is to promote effective law enforcement by the Secretary of the Treasury and to encourage industry cooperation with these efforts. The registration requirement is also meant to educate NDPs about their requirements under the BSA. In response to Congressional mandate, FinCEN issued three proposed regulations relating to the treatment of NDPs under the BSA.

On May 21, 1997, FinCEN proposed rules on the following subjects: (1) registration of money service businesses (NDPs); (2)suspicious transaction reporting by money transmitters and issuers, sellers and redeemers of money orders and travelers checks and (3) currency transaction reporting by money transmitters of overseas transmissions of $750 or more. In these proposed rules, FinCEN refers to NDPs as money service businesses." FinCEN held working meetings on the proposed regulations in cities throughout the U.S. during July and August 1997. On September 3, 1997 FinCEN announced another meeting relating to its proposed draft forms designed to accompany the proposed rules.

A. Definition and Registration of Money Service Businesses

[2] The MTRA describes itself as a regulatory organization comprised of members from various state banking departments. The MTRA invites industry involvement but considers itself a regulatory organization governed by regulators rather than industry participants.

The first proposed regulation (62 F.R. 27890) ("PR One") would define the term money service business" and also require the relevant businesses to register with Treasury and to provide a current list of their agents."[3] The term money service business" includes:

(1) currency dealers or exchangers;

(2) check cashers;

(3) issuers of traveler's checks, money orders or stored value;

(4) sellers or redeemers or traveler's checks, money orders or stored value; and

(5) money transmitters;

The inclusion of stored value products[4] in the definition of money service businesses is an attempt to come to fashion appropriate regulations for new types of money services. Stored value cards, along with other types of electronic currency, have been highlighted as the next potential vehicle for money laundering. According to FinCEN "the treatment of stored value and similar systems in the money services business registration rule is intended to constitute for the most part the beginning of the policy cycle for determining the most effective way to deal with advanced electronic payment systems under the [BSA]."[5]

By including stored value providers within the term money service businesses, these businesses are also treated as financial institutions subject to the general recordkeeping and reporting requirements of the BSA. For example, stored value providers will have to fill out CTRs for transactions equal to or greater than $10,000 and maintain records for transactions equal to or greater than $3,000.[6]

C. Reporting of Suspicious Transactions

The second proposed regulation (62 F.R. 27900) ("PR Two") would require money transmitters and issuers, sellers and redeemers of money orders and travelers

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[3] Definition and Registration of Money Service Businesses, 62 Fed. Reg. 27,890 (May 21, 1997).

[4] The definition of stored value provided by FinCEN is: funds or monetary value represented in digital electronics format (whether or not specially encrypted) and stored or capable of storage on electronic media in such a way as to be retrievable and transferable electronically. 62 Fed. Reg. 27,890, 27,893 (May 21, 1997).

[5] Id.

[6] Stored Value Systems Brought Under BSA by New Rules, Money Laundering Alert (June 1997), at 1.

checks to report suspicious transactions involving funds or assets of $500 or more.[7] PR Two specifically excludes stored value products from its scope. This regulation has been proposed, at least in part, to prevent money transmitters from assisting customers to launder funds. SARs should be filed for transactions:

(1) involving funds derived from illegal activity or intended to hide or disguise funds or assets;

(2) designed through structuring to evade the reporting requirements of the BSA; or

(3) appear to serve no apparent lawful purpose, and for which the money service businesses know of no reasonable explanation after examining the available facts relating thereto.[8]

FinCEN notes that current BSA rules have not been "tailored to appropriately reflect the particular operating realities, problems and potential for abuse of an industry that deals in sums far below $10,000 per transaction."[9] FinCEN is primarily concerned

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[7] Requirement of Money Transmitters and Money Order and Traveler's Check Issuers, Sellers and Redeemers to Report Suspicious Transactions, 62 Fed. Reg. 27,900 (May 21, 1997).

[8] FinCEN provides several examples of transactions that should be reported including:

- the contemporaneous purchase of multiple remittances in the same of similar amounted by the same person;
- large volume of transactions, sequential invoices, or both, directed to one correspondent from one agent (operating through single or multiple offices) on a single day;
- patterns of instruments or remittances just below the dollar thresholds required for particular Bank Secrecy Act reporting or recordkeeping requirements; and
- multiple senders of remittances using the same recipient's last name, address or telephone number

[9] 62 Fed. Reg. 27,900, 27,903. FinCEN states:

> The choice of a $500 threshold for suspicious transaction reporting by money service businesses reflects the judgment . . . that the levels of reporting appropriate for other financial institutions, for example, the $5,000 suspicious activity reporting threshold for banks, are not appropriate given the patterns of transactions prevalent in such money service bushiness. The threshold reflects FinCEN's understanding of normal transaction levels for the businesses involved. Given the fact that one of the purposes of suspicious transaction reporting is to identify structuring, a higher reporting threshold would significantly limit the effectiveness of the proposed rule. . . .

Id. at 27,904.

about the role of check sellers and money transmitters who receive funds and covert them into payment instruments or transfer them to distant locations. The conversion of potentially illegal proceeds is what FinCEN wants to prevent. Consequently, check cashers and currency exchanges are not subject to suspicious transaction reporting "[b]ecause the operations of those businesses generally involve disbursement rather than receipt of funds."[10] PR Two does apply, however to redeemers of money orders or traveler's checks for currency.

1. Wire Transfers and Money Laundering

Since August 1996, Treasury in cooperation with other federal and state government agencies, has been watching a select group of money transmitters in New York City. This project is known as the El Dorado Task Force. Twenty-three licensed transmitters and their 3,200 agents were the subject of a federal Geographic Targeting Order ("GTO") that was designed to track the illegal transmission of funds to Colombia.

The order was issued by Raymond W. Kelly, Under Secretary (Enforcement) of Treasury, in response to requests from U.S. Attorneys in New York and New Jersey, and senior officers from U.S. Customs and the Internal Revenue Service.

Under Secretary Kelly is permitted under the BSA to issue an order requiring that financial institutions adhere to special recordkeeping requirements if there is reason to believe that the requirements are necessary to prevent evasions of or to carry out the purpose of the BSA. The GTO issued by Kelly required targeted money transmitters to provide daily reporting concerning the senders and recipients of money remittances of $750 or more to Colombia. Transmitters were also required to report any patterns of transactions that appeared suspicious.

El Dorado had previously been monitoring currency flows to Colombia and had uncovered widespread laundering of narcotics funds within segments of the narcotics industry in New York."[11] The amount of money that was being sent to Colombia also seemed disproportionately high given the aggregate income of the Colombian community in New York. Once the GTO was in place, the volume of money being transferred electronically to Colombia diminished. At the same time that wire transfers decreased, U.S. Customs seized more physical cash being smuggled out of the country. The simultaneous decreases in wire transfers to Colombia and the increase in physical smuggling indicates that that the wire transfers were probably illicit. Furthermore, the number of transactions beneath the $750 reporting threshold appear to have doubled. This is evidence that New York customers who sent funds to Colombia were "structuring" their transactions to avoid being reported to Treasury pursuant to the GTO.

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[10] Id. A seller of money orders that is also a check casher would be subject to the suspicious activity reporting requirements by virtue of its sale of money orders. The seller of money orders would not, however, be required to report data with respect to its check cashing operations.

[11] Id. at 27,902.

2. Sale of Money Orders and Traveler's Checks

In addition to wire transfers, FinCEN is also concerned about the purchase of money orders and traveler's checks as a means to launder illicit funds. Money orders are almost cash equivalents and easily negotiable. Very often, the seller of a money order does not ask for identification from the purchaser. Money orders can also be made out to cash". The ease of redemption and negotiation make them attractive money substitutes and vehicles for transporting illegal proceeds.

Travelers checks are also potential vehicles for money laundering. Typically, travelers checks should be counter-signed at the time of issuance in the presence of an employee of the agent or entity that issues them to the customer. Agents, however do not always require a purchaser to sign the checks in his or her presence. Thus, the checks can be freely transferred to another person or entity and used for many commercial purposes. Thus, there is no record of who the original purchaser of the checks is. Persons engaged in money laundering are thus able to purchase large amounts of traveler's checks while remaining anonymous.

C. Transmission of Funds outside of the United States

The third proposed regulation (62 F.R. 27909) ("PR Three") would require money transmitters and their agents to report and retain records of transactions in currency of monetary instruments of at least $750 in connection with the transmission of funds outside of the United States.[12] Money transmitters would also be required to verify the identity of the senders of such overseas transfers. Money transmitters are defined as:

> (i) any person, whether or not licensed or required to be licensed, who accepts currency, or fund denominated in currency, and transmits the currency or funds, or the value of the currency or funds, by any means through a financial agency or institution, a Federal Reserve Bank, or other facility of the Board of Governors of the Federal Reserve System, or an electronic funds transfer network; or (ii) [a]ny other person engaged as a business in the transfer of funds.

FinCEN also refers to the El Dorado Task Force with respect to the rationale for PR Three as well. The Task Force has convicted 97 persons to date and obtained through seizure and forfeiture over $10 million of assets associated with money laundering trough licensed transmitters in New York. Drug traffickers used the transmitters were used to transfer money from the United states to Colombia. Customers would structure transactions to fall below the thresholds that would trigger reporting requirements under the BSA. Corrupt agents of money transmitters would accept illicit funds and then

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[12] Special Currency Transaction Reporting Require for Money Transmitters, 62 Fed. Reg. 27,909 (May 21, 1997).

transfer the funds in smaller amounts so as to fall below the $1000 CTR requirement. as FinCEN notes:

> Most often, the traffickers bring the agents [of money transmitters] large amounts of currency which needs to be returned to a drug source country., The agents create invoices which make it appear as if the money had been brought in by a number of different senders, in amounts below the recordkeeping and reporting thresholds. These corrupt agents also provide the money transmitters with lists of recipient names in the foreign countries for each remittance, again using a different name for each remittance, In this way, each time it appears as if there were a number of smaller, unrelated remittances instead of one remittance, in excess of $3,000 that would trigger the recordkeeping rules . . . or in excess of $10,000 which would trigger the filing of a [CTR].[13]

Treasury has proposed that money transmitters keep records for transactions that are greater than or equal to $750 as a way "to create a source of information that should help to stop the relatively uncontrolled outflow of narcotics proceeds through money transmitters." [14] FinCEN noted, however that the lowest currency reporting threshold used has previously been $3,000. The GTO that was issued by Under Secretary Kelly, in New York, however, was the first time that a $750 reporting requirement was instituted. FinCEN notes that the average transaction amount for individual funds transfers overseas is $320. Since $750 is twice that amount, it is less likely that there will be a decrease in legitimate transactions made by consumers.

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13 Id. at 27,912.

14 Id.

V. Regulation of Stored Value Products and Electronic Currency

A. *Description of Stored Value and Electronic Currency Products*

There is no single term for electronic currency systems. Payment systems that use technologies such as stored value cards, "smart" cards, and the Internet are often referred to by a variety of terms: cybermoney, cyberpayments, e-money, e-cash and digital cash are among some of the terms used.

1. Stored Value Products

Stored-value products are a recent innovation in payment systems technology. Stored value products possess certain basic characteristics. According to the Federal Reserve, stored-value products share three attributes: "(i) [a] card or other device electronically stores or provide access to a specified amount of funds selected by the holder of the device and available for making payments to others; (ii) the device is the only means of routine access to the funds; (iii) the issue does not record the funds associated with the device as an account in the name of (or credited to) the holder."[15]

Stored-value cards are also known as "smart" cards, prepaid cards or value-added cards. These cards maintain on a computer chip a stored value of funds available to be used by a person for various types of retail transactions. A balance is recorded on the card which is debited at a point-of-sale terminal when a consumer or individual makes a purchase. Typically, a consumer will pay a bank or other provider money in exchange for a card that is loaded with value. The consumer uses the card rather than paper currency to purchase good and services. Merchants who accept smart cards can transfer the value of accumulated credits to their banks accounts. A smart card is not typically used for transactions over the Internet. Several new services however provide for remote payments to be made by electronic currency that is stored on the hard drive of a person's computer.

When discussing smart cards, commentators refer to "closed" and "open" systems. A closed system is one where the stored value card can be used only for goods and services provided by the card issuer directly. For example, a university may issue a stored-value card which students may use to purchase books, cafeteria food and fares on the university's bus system. An "open" system is one where the issuer is not the provider of goods and services but is perhaps part of a group of issuers whose stored-value card are accepted as a form of payment by a host of merchants. At the Olympics, 3 banks issued Visa Cash Cards that were accepted by 1,500 merchants.[16]

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[15] Board of Governors of the Federal Reserve System, Report to the Congress on the Application of the Electronic Fund Transfer Act to Electronic Stored-Value Products (March 1997), at 1.

[16] For an excellent discussion of stored value products, see ABA Task Force on Stored Value Cards, A Commercial Lawyer's Take on the Electronic Purse: An Analysis of Commercial Law Issues

2. **Other Forms of Electronic Currency**

Some electronic currency systems use the Internet as a means of transfer of payments. Some of these systems require that an account be held by he customer at a financial institution through which the value "clears" or is transferred. Other systems use digital value or tokens. A customer purchases the tokens or values and then stores them on a computer for future use. Stored-value cards are used primarily for point-of-sale transactions. Electronic value which is stored on a personal computer would be used for sales where a buyer is at a location remote from the seller.

A customer may purchase electronic currency from a bank or other provider. For example, a bank may issue digital "coins" that possess unique serial numbers that identify a specific amount of monetary value. When the user requests his or her electronic currency, the bank will debit his or her account and credit a cash liability on the bank's books. The user will then store the electronic coins on his or her computer. A user will spend coins from his or her account by transferring the coin to a merchant. Unlike physical delivery, delivery will occur via the computer. The merchant can them send the coins back to the issuing bank for credit. In another model, an issuer will maintain a central database that will automatically transfer electronic coins from the consumer to the merchant while also tracking and ensuring that the consumer receives the product that he or she has purchased over the computer.

At present, there is no consensus over the nature and extent of government oversight of electronic currency systems.

B. Potential for Money Laundering

The transfer of electronic currency may provide an opportunity for money laundering. For example, if a payment system allows transfers of electronic currency between individuals, this may increase the probability of fraud and counterfeiting. The amount of value that can be retained on a smart card or other type of electronic currency token will affect whether people will use these products for money laundering. If one can store a large amount of value on a card that is highly portable and transferable, this will increase the likelihood of money laundering.[17]

Associated with Stored Value Cards and Electronic Money (1996), 12-24.

[17] The Financial Action Task Force ("FATF"), an intergovernmental body created initially by the G-7 nations, was formed to develop and promote policies to combat money laundering. FATF recently issued an annex to its 1996 Report on the Typologies of Money Laundering which addresses "Issues Concerning New Payment Technologies." The FATF Annex states:

> the physical bulk of cash has always presented problems to the money laundered; it is not uncommon for money to be abandoned simply because it could not be moved quickly enough. E-money reduces the need for currency smuggling. Instead of a single shipping container or many false-bottomed suitcases, vast amounts of money could be transmitted instantaneously and

Electronic currency may give people the ability to move money globally without using banks as intermediaries. Theoretically, funds can be transferred to jurisdictions with less stringent money laundering laws via the computer. The rapid nature of transactions (like wire transfers) will also make it difficult for law enforcement agencies to detect money laundering. Alternatively, a smart card encoded with a large amount of electronic money can be slipped into a person's pocket and taken anywhere in the world.

C. Regulation of Stored Value Cards

As mentioned above, PR One will include stored value systems within its definition of money service businesses. Stored-value providers will be required to register with Treasury on a biennial basis.

The Federal Reserve has not yet promulgated any rules for stored-value cards. The Federal Reserve previously issued proposed rules governing stored-value cards and their treatment under Regulation E ("Reg E") of the Electronic Funds Transfer Act ("EFTA"). Reg. E contains consumer protection for unauthorized or erroneous electronic funds transfers ("EFTs"). For example, the regulation requires printed receipts for all consumer EFT transactions.

In May1996, the Federal Reserve's invited comments on a proposed rule which included a broad exemption from Reg. E reporting and consumer notification requirements for stored-value cards worth less than $100.[18] Reg. E. would apply only when stored-value cards would be used to access a deposit account. Thus, stored value products such as Citibank Visa Cash Cards and Chase Manhattan Mondex cards could have been subject to Reg. E because the cards are linked to customer bank accounts. Reg. E also includes error resolution procedures for consumers. The receipt and error resolution requirements would increase the cost of operating stored-value smart card systems. This proposal met with mixed review from industry participants.

In April 1997, the Federal Reserve stated that it would not impose regulations on stored-value products because this would impede development of these products. This decision came after The Federal Reserve issued a report on EFTA and stored-value products to Congress in March 1997.

The Boston-based National Center for Consumer Law has recently proposed a federal bill that would require stored-value providers to be regulated by the federal government or to put up a bond for twice the value of one year of card sales. The

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securely with a few key strokes.

Annex, at 7.

[18] Electronic Funds Transfers (Regulation E), 61 Fed. Reg. 19,696, (proposed May 2, 1996).

proposed bill would also impose fees, set up liability guidelines for lost funds, and mandate printed receipts for transactions over $5.[19]

[19] Regulators Take a Do-No-Harm Approach to New EFT Technologies, Bank Network News (July 9, 1997).

D. State Regulation

It is presently unclear whether laws and regulations relating to the licensing of NDPs as well as the reporting and recordkeeping requirements imposed on money transmitters also ally to providers/transmitters of electronic currency.