

MEMORANDUM

To: Drafting Committee and Observers
Proposed Act on Money Services Business (formerly the Proposed Act on Nondepository Providers of Financial Services)
National Conference of Commissioners on Uniform State Laws (NCCUSL)

From: Anita Ramasastry, Reporter

Re: Third Draft of Proposed Act

Date: February 22, 1999

Please find attached the Third Draft of the Proposed Money Services Business Act (“Proposed Act”). The Proposed Act was previously referred to as the Nondepository Providers of Financial Services Act. At the October 1998 Drafting Committee meeting, the Drafting Committee and Observers voted to change the name to Proposed Money Services Business Act. The NCCUSL Executive Committee subsequently approved this name change in January 1999.

The Drafting Committee recommended the name change because it was felt that the term “money services businesses” more aptly described the group of organizations that are to be regulated under the Proposed Act – namely money transmitters, payment instrument sellers, stored-value providers, check cashers and currency exchangers. The Financial Crimes Enforcement Network (“FinCEN”) of the United States Department of Treasury has previously used this term in its proposed rulemaking concerning such entities in May 1997.

Also attached to this memorandum are copies of relevant state legislation and other information which may be of use to the Drafting Committee and Observers during the March meeting. In particular, I have enclosed a copy of a table which compares the two model acts that form the basis for much of the Proposed Act – the Non-Bank Funds Transfer Group Model Act Regulating Money Transmitters and the President’s Commission on Model State Drug Laws Model Money Transmitter Licensing and Regulation Act. This table provides a quick reference as to the major substantive similarities and differences between these two models. As mentioned previously, individuals who represent some of the larger money transmitters drafted the Non-Bank Funds Transfer Group draft. Representatives of state law enforcement prepared the President’s Commission draft. As each model encapsulates slightly different goals and ideas, it is hoped that the Proposed Act can build on the strengths of both models and achieve compromise and consensus on issues where there are differences.

I. Major Changes in the Third Draft

- ***Licensing of Check Cashers and Currency Exchangers***

The September 1998 Draft included a separate licensing regime for two distinct groups of money services businesses. The first group was money transmitters, payment instrument sellers and stored value providers. The second group was check cashers and currency exchangers. The Drafting Committee and Observers noted that check cashers and currency exchangers did not pose the same type of safety and soundness concerns for state regulators as other types of money services business because they did not accept funds from consumers for obligations that might remain unpaid. Rather, both check cashers and currency exchangers immediately provide customers with funds as part of their services. Thus, there is no risk that customers may lose their money (as with the purchase of a money order which might not be redeemed on a future date). Therefore, the Drafting Committee and Observers recognized that check cashers and currency exchangers should be subject to different types of reporting and recordkeeping requirements and should be exempt from bond requirements.

In the September 1998 Draft (“Second Draft”), two licensing regimes were created. Part 3 of the Second Draft created a licensing system for money transmitters, payment instrument sellers and stored value providers. Part 4 of the Second Draft created a separate licensing regime for check cashers and currency exchangers.

During the October 1998 Drafting Committee meeting, the Drafting Committee and Observers voted to further narrow the extent to which check cashers and currency exchangers were subject to licensing requirements. **In the Third Draft, Article 3 (formerly Part 4 of the Second Draft), requires check cashers and currency exchangers to obtain a license ONLY IF they are not authorized delegates of money transmitters, payment instruments sellers or stored value providers.**

Committee Members and Observers felt that check cashers and currency exchangers who act as authorized delegates would already be identified (for law enforcement purposes) as part of the information supplied to the state regulator by the principal licensee. Additionally, the Proposed Act permits the state regulator to take enforcement actions against both licensees and authorized delegates. Therefore, the Committee and Observers felt that check cashers and currency exchangers would be subject to anti-money laundering provisions of the Proposed Act if they were EITHER (1) authorized delegates or (2) licensed separately under Article 3.

The Drafting Committee and Observers should consider carefully whether Article 3 imposes any distinct burdens on check cashers and currency exchangers who are non-delegates (as compared with those entities exempt from licensing by virtue of their authorized delegate status). Additionally, the Drafting Committee should consider whether exempting certain check cashers and currency exchangers from a minimal licensing or registration scheme would in any way impede access to certain books, records and papers of such entities.

More generally, the Drafting Committee and Observers should also consider whether a different term should be used for Article 3 licensing to distinguish it from Article 2 licensing in the Proposed Act. There has been some suggestion of employing the term “registration” for check cashers and currency exchangers.

- ***Treatment of Stored Value***

At the October 1998 Drafting Committee meeting, the Committee and Observers voted to retain stored value products/instruments within the scope of the Proposed Act. It was agreed, however, that stored value cards which are used for closed-end systems, to purchase certain types of goods and services (e.g., phone cards and metro cards) should not be subject to licensing under the Proposed Act. The Drafting Committee and Observers both felt that the previous definitions of stored value and closed end stored value products contained in the Second Draft were unsatisfactory and a bit unclear.

As noted in the Second Draft, several states have begun to include stored value within their existing money transmission legislation. Connecticut, for example, has defined stored value as a form of “electronic payment instrument.” This term would also include electronic traveler’s checks. With the assistance of Observers, new definitions of “stored value instrument” (Section 1-102(26)) and “stored-value provider” (Section 1-102(27)) have been included in the Third Draft. These definitions mirror the Connecticut approach more closely. Information concerning the rationale for Connecticut’s amendments to its money transmission statute is included as an attachment to this memo.

The Drafting Committee and Observers will need to consider further whether the Connecticut approach is a preferred approach and whether other types of electronic currency products also fall within the current definition (and to what effect). More generally, the Committee and Observers should also consider whether the definition of stored value provider could be subsumed into the definition of payment instrument seller. Similarly, the term payment instrument seller might also be subsumed into the definition of money transmitter.

- ***Permissible Investments***

At the October 1998 Drafting Committee meeting, Committee members and some Observers expressed discomfort with the list of permissible investments contained in the Second Draft as former Section 1-102(26). This Section has been moved into the substantive provisions of the Proposed Act and is included as Section 602 in the Third Draft.

The items that Certain Committee Members and Observers felt might be too risky included:

- (1) shares in money market mutual funds, interest-bearing bills or notes or bonds, debentures on stock traded on any national securities exchange or on a national over-the-counter market or mutual funds primarily composed of one or more investments as described in this Section;

- (2) a demand borrowing agreement made to a corporation or a subsidiary of a corporation whose capital stock is listed on a national exchange; and
- (3) receivables that are due to a licensee from its authorized delegate pursuant to a contract which are not past due or doubtful of collection.

Industry Observers pointed out that these types of permissible investments were typically contained in existing state legislation. The same Observers emphasized that it was important for many licensees to have diverse portfolios which included the type of investments listed above.

An alternative list of permissible investments has been included in the Third Draft as Section 601 (Alternative 2). This list of investments mirrors the list contained in the Second Draft. The main difference, however is it limits the aggregate amount of each of these contested categories of investments to 20% of the licensee's total permissible investments. Additionally, a licensee may not invest in more than 10% of any one entity whose investments fall into these categories. Section 602 Alternative 2 is an attempt to balance the concerns about the safety of the investments made by licensees with the needs of money services businesses to have diverse investment opportunities. The Drafting Committee and Observers should carefully review this Section and consider forming a Task Force to further refine this provision.

- ***Enforcement: Inclusion of Temporary Cease and Desist Authority***

Observers who represent both law enforcement and state regulators have previously expressed concern that the September 1998 draft did not give the state regulator enough authority to take prompt and corrective action in the event that a licensee was violating the law or engaging in activity that was hazardous to consumers or the public.

In the Second Draft, the superintendent was able to seek a cease and desist order against a licensee or its authorized delegates only after providing notice to the licensee and holding a hearing. Observers noted that this would not give the superintendent any leeway with respect to emergencies.

A new Section 703 has been added to the Third Draft. Section 703 allows a superintendent to issue a temporary cease and desist order if a licensee's or authorized delegate's conduct is likely to:

- (1) cause immediate and irreparable harm to the licensee, its customers or the public;
- (2) cause insolvency or significant dissipation of assets of the licensee; or
- (3) weaken the conduction of the licensee or otherwise prejudice the interests of consumers.

A temporary order would remain in place pending the completion of administrative proceedings required to issue a normal cease and desist order. The licensee, however, has the ability to challenge such a temporary order.

The Drafting Committee and Observers should review this provision and consider how to refine it to properly balance the interest and needs of both the regulator and licensees.

II. Other Issues that Need Further Consideration at the March Meeting

- ***Money Laundering Provisions***

Section 507 of the Proposed Act requires licensees to comply with all federal currency reporting, recordkeeping and suspicious transaction reporting requirements. Section 507 also states that the timely filing of federal reports shall be deemed compliance with the state reporting requirements. This provision is an anti-money laundering provision designed to require licensees and authorized delegates to comply with the federal Bank Secrecy Act. This section also allows the superintendent to take enforcement measures against a licensee for non-compliance.

Some Observers have noted that the current provision is too brief and therefore does not properly achieve its objective. As an alternative, it has been suggested that the Drafting Committee examined the Model Financial Transaction Reporting Act (“MFTRA”), which was prepared by the President’s Commission on Model State Drug Laws. This model act was created as a companion piece of legislation to the President’s Commission Model money Transmitter Licensing and Regulation Act. The Drafting Committee could either incorporate the relevant provisions of the MFTRA into the Proposed Act or simply eliminate Section 507 altogether and make a reference to the MFTRA as a separate and stand-alone piece of legislation which states may choose to adopt.

Alternatively, the Drafting Committee and Observers may wish to consider alternative provisions found in existing state legislation. Attached to this memorandum are copies of the MFTRA and also Florida and Georgia legislative provisions which deal with money laundering prevention and currency reporting requirements.

- ***Structure of the Proposed Act***

The Style Committee has noted that there are perhaps too few provisions for the Proposed Act to be divided into different Articles (formerly referred to as “Parts”). The Third Draft retains the various Articles (“Parts”) in order to keep the different topics of the Proposed Act separate. The Non-Bank Funds Transfer Group model and the President’s Commission model both do not use different articles. Rather, each model act simply numbers the sections in sequence ((Section 1,2,3, etc.).

The Drafting Committee and Observers need to consider the possible structure of the Act. Some of the possible choices include:

- (1) **Unitary act with sequential numbering.** The possible problem with this approach is that the Proposed Act currently has two types of licensing regimes and therefore it may be confusing to group all sections of the Proposed Act together sequentially

- (2) **Group common provisions of the Act which apply to all money services business together and keep licensing provisions for money transmitters, payment instrument sellers and stored value providers (Part 2) and check cashers and currency exchangers (Part 3) separate.** In essence, the Proposed Act could have as few as 3 Articles.

The Florida Money Transmitters' Code takes this approach. The only problem with this approach is that the common provisions are grouped together at the beginning of the Code. Thus, you have provisions dealing with revocation of licenses, enforcement, penalties for breach of the act, etc, preceding a general discussion of how a money transmitter is licensed. In other words, the Florida Code discusses how a license can be revoked before it discusses how and when a license might be granted.

Table of Disposition for Third Draft

<u>September 1998 Draft Section</u>	<u>March 1999 Draft Section</u>
102(5) (definition of check issuer)	Deleted
102(6) (definition of check seller)	Deleted
102(7) (definition of closed-end stored value product)	Deleted
102(8)	102(5)
102(9)	102(6)
102(10)	102(7)
102(11)	102(8)
--	102(9) (new definition of engage in the business)
102(12)	102(10)
102(13)	102(11)
102(14)	102(12)
102(15) (definition of location)	Deleted
--	102(13) (new definition of limited station)
102(16)	102(14)
102(17)	102(15)
102(18)	102(16)
102(19)	102(17)
102(20)	102(18)
102(21)	102(19)
102(22)	102(20)
--	102(21) (new definition of payment instrument seller)
102(23)	102(22)
102(24) (definition of permissible investments)	602
102(26)	102(23)
102(27)	102(24)

September 1998 Draft Section**March 1999 Draft Section**

102(28)	102(25)
102(29) (definition of stored value)	Deleted
--	102(26) (new definition of stored value instrument)
102(30)	102(27)
102(31)	102(28)
102(32)	102(29)
102(33)	102(30)
201 (scope)	Deleted
202 (power of superintendent)	103
203 (exclusions)	104
204 (license requirement)	105
Part 3	Article 2
301	201
302	202
303	203
303 (should have been 304 – license renewal)	204
305	205
306	206
Part 4	Article 3
401	301
402	302
403	303
404	304
405	305
Part 5	Article 4
501	401
502	402

September 1998 Draft Section**March 1999 Draft Section**

503	403
Part 6	Article 5
601	501
602	502
603	503
604	504
605	505
606	506
607	507
--	508 (new section: electronic receipt of records)
608	509
Part 7	Article 6
701	601
--	602 (new definition of permissible investments)
Part 8	Article 7
801	701
802	702
--	703 (new section: temporary cease and desist orders)
803	704
804	705
805	706
806	707
Part 9	Article 8
901	801
902	802
Part 10	Article 9
1001	901

September 1998 Draft Section

March 1999 Draft Section

1002

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