



SINCE 1902

CONFERENCE OF STATE BANK SUPERVISORS

State Model Payments Law Request for Information February 2019

Background

In 2017, state regulators launched Vision 2020 – a series of initiatives from the Conference of State Bank Supervisors (CSBS) to modernize state regulation of non-banks. Vision 2020 reflects a sustained commitment by state regulators to drive toward a an integrated, 50-state licensing and supervisory system, leveraging technology and smart regulatory policy to transform the interaction between industry, regulators, and consumers.

Achieving this vision should result in a regulatory system that makes supervision more efficient by implementing standards across state lines. These actions will better support start-ups and enable national scale while continuing to protect consumers and the financial system.

To inform this process, CSBS commissioned a Fintech Industry Advisory Panel (“Advisory Panel”). The Advisory Panel is designed to support state regulators’ increased efforts to engage with financial services companies. The Advisory Panel engages with the CSBS Emerging Payments and Innovation Task Force and other state regulators to identify actionable steps for improving state licensing, regulation, and non-depository supervision and for supporting innovation in financial services.

The Fintech Industry Advisory Panel was split into two subgroups – payments and lending. The payments subgroup produced a detailed report on state money services issues, available [here](#). This request for comment focuses on the recommendations outlined in the payments report.

Request for Comment

State regulators are committed to a transparent and inclusive approach to modernizing money services laws and policies. CSBS requests public comment on the Recommendations of the Payments Subgroup of the Fintech Industry Advisory Panel (“Recommendations”) and seeks feedback on specific questions that will help inform state regulators as we finetune the regulatory structure for money services. All comments will be made available at www.csbs.org. CSBS reserves the right to reject comments with inappropriate content.

Comments may be submitted by any of the following methods:

Electronic Comments

Submit all electronic comments via email to modelpaymentslaw@csbs.org. CSBS will only review PDF files.

Paper Comments

Send paper comments to

Attn: Emerging Payments Task Force
Conference of State Bank Supervisors
1129 20th Street NW, 9th Floor
Washington, D.C. 20036

Due Date

Comments are requested no later than April 12, 2019.

Contact Information

For questions, please email Matthew Lambert, CSBS Non-Depository Counsel, at mlambert@csbs.org.

Purpose & Standards

To address the Recommendations of the payment's subgroup, CSBS has formed a working group of state regulators tasked with fashioning coordinated solutions for the actionable items identified by industry. Since many of the solutions can be implemented without statutory change, the intent is to release improvements on a rolling basis in order to quickly bring the regulatory improvements to market. When complete, all improvements are expected to be memorialized in a model law for states to adopt in whole or in part as necessary.

When considering Recommendations and comments, the working group will rely on the following policy standards:

- Regulation must sufficiently protect consumers from harm, including all forms of loss.
- Regulation must not limit the states' ability to prevent bad actors from entering the money services industry.
- Regulation must preserve public confidence in the financial services sector, including the states' ability to coordinate.

In order to ensure the state regulatory framework is risk-focused, for each issue, the working group will strive to:

- Identify the relevant risks;
- Assess the impact of the risks; and
- Establish and communicate policy decisions that address the risks.

Regulation developed and communicated using risk as the foundation will help strike a balance between principles-based regulation and prescriptive regulation needed for certainty.

Request for Comment

Using the payments subgroup Recommendations as a guide, CSBS requests public comment on the following issues:

- The scope of covered money transmission activities and applicable exemptions;
- The change in control process, including the personal vetting requirements for individuals deemed new control persons;
- Prudential regulations – in particular, permissible investment, net worth, and surety bond requirements;
- Supervision processes; and
- Coordination – in particular, how states can ensure the areas outlined above are implemented consistently without state-by-state policy diversion or needless duplication of effort.

It will be helpful if comments are framed with an eye towards the stated policy standards and risk.

Money Transmission Activities & Exemptions

The Advisory Panel reports that despite the general similarity of state money transmission laws, each state defines and interprets money transmission and its exemptions differently. As a result, industry describes investing unwarranted time and money interpreting how money transmission is defined, and which persons and activities are exempt state-to-state.

The Advisory Panel has urged the states to harmonize the definitions and interpretations on a national basis. To do so, they recommend:

- Leveraging existing interpretations, analysis, guidance, regulations, and public policy considerations at the federal level and among sister states;
- Adopting risk-based principles to analyze activities to determine whether a regulatory nexus exists; and
- Harmonizing and making transparent the treatment of nine common exemptions, including:
 - Agent of the payee;
 - Insured prepaid card;
 - Closed loop prepaid access;
 - Payment processors;
 - Payroll services & 1099 contractors;
 - Agents and service providers of banks;
 - Pre-funding;
 - Payment of business taxes; and
 - Business to business activities.

CSBS seeks comment on the Advisory Panel's recommendations and on additional considerations for regulated activities and exemptions. CSBS also seeks comments on the following questions:

1. *Can federal definitions sufficiently cover the realm of activities that should be subject to state law? If federal definitions are insufficient, are there preferred models from state law?*
2. *How should the states simplify the process of determining whether a product is subject to regulation? And can this be done without state-by-state analysis?*
3. *How should the states consistently perform risk analyses considering the variety of business models and methods?* CSBS encourages commenters to submit risk-based procedures or cite relevant procedures from other jurisdictions.
4. *Should check cashing and currency exchange be included in efforts to harmonize money services activities and exemptions?*

Control

States exercise gatekeeping responsibilities over most financial services industries. Typically, this is done by reviewing individuals that exert control over a financial entity ("control persons"), ensuring that they have the appropriate experience, character, and fitness to provide financial services to the public. In money transmission, the Advisory Panel described this fundamental role of regulation as a means to "ensure that only appropriately qualified and vetted parties participate in the money transmitter system."

Control Events

States vet control persons when they initially apply to become licensed and thereafter when there are changes in ownership or management. Changes in ownership or management are typically referred to as "change in control." The Advisory Panel reports differences in standards and procedures for change in control create significant administrative burden. The companies state they must know the different change in control triggers for each state, and what to do in each state when a change in control occurs. To address these differences, the Advisory Panel has recommended streamlining the meaning of control, the standards for a change in control, and the process to follow once a change in control occurs.

Given the range of possibilities for control definitions, standards, and process, CSBS asks the following:

1. *What is the most appropriate definition for a change in control?*
2. *Are there alternative methods of determining whether a change in control has occurred beyond ownership percentage changes or changes in managerial duties?*
3. *Are there fundamental differences in type and extent of control? If so, is it possible to structure change in control procedures proportionate to the risk associated with the amount and type of control?*

Control Persons

States typically examine the financial soundness of investors in financial institutions. This involves credit checks, an analysis of the individual's history in financial services, analysis of the individual's financial capacity, and other measures that determine the likelihood of a control person's ability to garner the public's trust.

The Advisory Panel reports that certain control persons have more difficulty than others in this vetting process. As described by industry, venture capital firms invest in startups early, often, and without the promise of further investment. This is often done through the fund's legal entity (e.g. limited partnership), not through individual investors. In such scenarios, there may be dozens of individuals in control of the investing vehicle, but none involved in the financial services business. The result is a vetting process for individuals that purportedly pose no risk to the institution or its customers, and who cannot be compelled to invest additional capital in the event of financial distress. The Advisory Panel argues vetting these individuals is unnecessary and hinders investment.

To address this issue, the Advisory Panel has suggested states recognize the distinction between passive and active ownership. Further, the Advisory Panel argues passive investments that carry no promise of future investment should preclude the need for a financial analysis of the investors. They reason that if passive investors cannot be forced to contribute more capital, there is no need to determine whether they can afford the investment.

Additionally, the Advisory Panel noted the opportunity for increased efficiencies via the Nationwide Multistate Licensing System ("NMLS"). They contemplate venture capital investors providing their information through NMLS, making it easier for them to invest in multiple financial services companies.

Lastly, the Advisory Panel emphasizes an appreciation for the functionality of NMLS but noted the need for improvements for foreign control persons. Lack of clarity on the vetting procedures and review standards applicable to foreign control persons often leaves companies guessing and slows investment. The Advisory Panel recommends that the States seek to identify providers of the equivalent criminal background checks in foreign countries and establish minimum standards for financial information in cases where credit checks do not have the same utility as in the U.S.¹

¹ During discussions, industry cited New York as an example of a state that sets clear standards foreign control persons need to meet and the information that must be contained in financial and criminal background reports. See *NY Money Transmitter License Amendment Checklist (Company)*, Information Regarding Control Persons Residing in Foreign Jurisdictions, Page 12 (6 April 2018). Available at https://mortgage.nationwidelicencingsystem.org/slr/PublishedStateDocuments/NY_Money_Transmitter-Company-Amendment-Checklist.pdf.

CSBS seeks comment on the Advisory Panel’s recommendations and seeks comments on additional factors that are relevant to change of control policies and procedures. CSBS also seeks comments on the following questions:

1. *Are static definitions (e.g. ownership percentage, managerial titles) sufficient for determining control?* If not, please describe alternative measures that can be used to determine an individual’s influence on a financial institution.
2. *For foreign control persons, is it preferable for the states to (a) create a central resource for acceptable financial and criminal reports used in other countries, or (b) provide minimum requirements that foreign reports must meet?*
3. *What, if any, is the appropriate standard for bifurcating licensure standards for individuals?* Please elaborate if there are examination procedures that could give regulators the ability to determine that low-risk individuals haven’t assumed new roles or exerted unreported authority.
4. *Are venture capitalists interested in a pre-vetting process to streamline investment in nonbank financial services?* Please indicate whether venture capitalists would be willing to periodically update an investor profile and attest to the accuracy of information.

Prudential Requirements

Often overlooked, state safety and soundness requirements have served as a hallmark of consumer protection in the money services industry. To protect consumers from loss and malfeasance, the states have adopted a successful financial safety and soundness system that protects consumer funds in the absence of deposit insurance.

The three prongs of money services prudential regulation are net worth, surety bonds, and permissible investments. Each serves a different fundamental purpose:

Fundamental Purposes	
Net Worth	<ul style="list-style-type: none"> • Baseline measure of solvency • Baseline measure of ability to do business & cover losses
Surety Bond	<ul style="list-style-type: none"> • Mitigates consumer losses in event of failure • Establishes market-based risk analysis
Permissible Investments	<ul style="list-style-type: none"> • Ensures 100% of customer funds are liquid during operations • Ensures 100% of customer funds are available as capital in the event of failure • Safeguards customer funds from operational risks of company

Currently, the Advisory Panel reports that states generally require all three safety and soundness requirements to be met independently without considering the effect of the other requirements.

The Advisory Panel suggests that states examine the legislative history relative to safety and soundness requirements, including net worth, surety bonds, and permissible investments, to determine whether the intent is for these prudential requirements to be additive. They alternatively ask for states to identify a principles-based standard for consistent application of safety and soundness requirements.

Net Worth & Surety Bonding

The Advisory Panel described significant variance in the implementation of net worth and surety bond requirements. States typically have broad discretion to require net worth and surety bond amounts between a minimum and maximum range established by statute. In practice, industry reports inconsistent application of inconsistent requirements, complicating a licensee's ability to comply. The Advisory Panel has asked for state regulators to make net worth and bonding requirements more consistent and consider the establishment of one or more national standards.

Permissible Investments

Generally, licensees must hold customer funds in safe assets identified by statute. States have specific requirements about what types of investments are permissible and the way they are calculated. Like risk-based capital requirements for banks, some states limit the extent to which certain assets count towards protecting customer funds ("Limited Assets"). Limited assets are often subject to "haircuts," which has the effect of requiring licensees to hold more of these riskier assets than would otherwise be required for a safe asset like cash or government backed obligations. The Advisory Panel recommends the adoption of common definitions, uniform risk-based principles, and a consistent approach for maintaining these permissible investments.

CSBS seeks comment on the Advisory Panel's recommendations and seeks comments on additional factors that are relevant to improving prudential requirements. CSBS also seeks comments on the following questions:

1. *What is the appropriate balance between (a) prescriptive prudential requirements and (b) principle-based prudential requirements?*
2. *In the event states adopt principles-based prudential requirements, what are the appropriate regulatory tools to address significant prudential problems?* For example, certain bank-like requirements may be appropriate for certain classes of money transmitters. Capital and liquidity buffers may be appropriate for the most complex institutions, whereas prompt corrective action requirements may be a means to protect consumer funds at startups with limited capital.²

² See, e.g., [Guidance for national authorities operating the countercyclical capital buffer](#), Basel Committee on Banking Supervision (December 2010) (Capital Buffer); [Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools](#), Basel Committee on Banking Supervision (January 2013) (Liquidity Coverage Ratio); [12 USCS § 1831o](#) (Prompt Corrective Action).

3. *Which approach is preferred to securing customer funds – (a) PSD2’s safeguarding requirements, (b) the Uniform Money Services Act permissible investment requirements, or (c) another approach to protecting consumer funds?*
4. *If national institutions are given bank-like prudential requirements, what metrics should be used to ensure customer funds are protected? Please elaborate in terms of capital, asset quality, management, earnings, liquidity, and sensitivity to market risk.*
5. *How should prudential requirements adjust to differing business models and size?*
6. *How should prudential requirements be implemented on a national basis? What is the ideal mechanism to ensure the standards for a national company are consistent across state lines?*
7. *Should small or single state money services businesses be able to opt out of a national standard, retaining the regulatory requirements in place today? In 2018, single-state licensees comprised 40% of all money transmitters (180 of 440 money transmitters).*

Supervision

State money services laws give supervisory and enforcement authority to state regulators. Though supervisory authority is sovereign to each state, considerable work has gone into coordinating supervision on a national basis. To date, 47 states, the District of Columbia, and Puerto Rico have signed the Nationwide Cooperative Agreement & Protocol for MSB Supervision (“Protocol and Agreement”).³ The protocol and agreement is designed to minimize regulatory burden and conserve regulatory resources. As a result of this cooperation, the states have increased efficiency by performing multistate exams, (two or more states performing a single exam together).

Though there has been an overall increase in supervisory efficiency over the past decade, the Advisory Panel has outlined areas for improvement:

- Large companies are often subject to several exams per year.⁴
- Significant variation in:
 - Information requested;
 - Format for producing information; and
 - Calculation methods for requested information.
- Repetitive information requests, including:
 - Duplication of information produced in licensing process; and
 - Duplication of information produced for other states.

³ Available at <https://www.csbs.org/cooperative-agreements>.

⁴ Though the Protocol and Agreement encourages 6-months between state exams, industry reports this goal is often overlooked. See *Protocol for Performing Multi-State Examinations*, Section IV, Paragraph C (January 2012). “Independent Examinations should be limited in observation of the Coordinated Goals. Furthermore, Participating State Regulators shall strive for a period of at least six (6) months between any on-site Independent Examinations unless conditions warrant otherwise.”

Industry notes the states have the tools necessary to remedy reporting problems. Most states use NMLS to license their money transmitters, and many use the NMLS MSB Call Report for standardized transaction and financial reporting. However, industry reports that most states do not use all the functionality available in NMLS. As a result, companies are required to upload, email, and mail documents across the country, despite the existence of a central repository for regulatory information.

Further, industry notes that NMLS MSB Call Report information is rarely utilized. As a result, companies submit information through NMLS, and then reproduce the same information in a state-specific format when examiners are on site. To remedy this issue, the Advisory Panel has recommended that state regulators prescribe unified reporting formats and parameters, and that efforts be made to reduce the documentation burden to licensees by leveraging NMLS for the delivery of relevant documentation.

Finally, the Advisory Panel notes the opportunity for the payments industry and State regulators to strengthen their communication beyond intermittent examination cycles. Ideally, companies should be able to communicate problems and action plans on a near real time basis, which can be monitored by regulators through regular reporting and subsequently reviewed on-site during regularly scheduled exams.

CSBS seeks comment on the Advisory Panel's recommendations and seeks comments on additional factors that are relevant to improving the exam cycle. CSBS also seeks comments on the following questions:

1. *Are any changes to law necessary to improve supervision, or could most issues be solved through improved processes?* When commenting, it would be helpful to discuss specific laws or interstate procedures.
2. *What laws, policies, and/or procedures are necessary for states to rely on the work of other states while still ensuring consumers in their state are protected?*
3. *Should states focus on improving the current supervisory coordination process, or is a more centralized framework necessary?* (e.g. elaborate on the role of off-site monitoring, the development of the [State Examination System](#), or greater reliance on industry self-assessment, etc.).
4. *How should examiners verify reported information?* Please elaborate on procedures that verify reported information without the need for duplicating the information.
5. *Given new technology deployed in NMLS, is it preferable for industry to generate information upon request or as a regular part of reporting?* For example, the NMLS MSB Call Report includes balance sheet and financial statement information that must be verified with audited financial statements. Would industry prefer to continue providing audited financial statements upon request during an exam, or would it be more efficient to upload the auditor's documents in near real time?

Next Steps

With the Fintech Industry Advisory Panel's first task complete, the states intend to advance the industry's recommendations to implementation. CSBS is committed to performing this task in a transparent manner, and will regularly engage with industry, consumer groups, and other stakeholders. In the coming months, CSBS and the states will develop policy and draft preliminary materials, all of which will consider industry recommendations and public comments. When complete, CSBS will make drafts available for comment before finalizing. We look forward to continued engagement with industry and the public as we strive to meet our common goals of a safe and modern regulatory system.