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CONFERENCE OF STATE BANK SUPERVISORS

MSB Model Law  
Executive Summary  
September 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. To help outline the areas in need of alignment, CSBS created a Fintech Industry Advisory Panel (“Advisory Panel”), which completed its initial report in early 2019.

To address the recommendations of the Payments Subgroup of the Advisory Panel, the CSBS Non-Depository Supervisory Committee has drafted a model money services businesses (“MSB”) law focused on coordinated solutions for the actionable items identified by industry. The CSBS model MSB law draft is based on and overlays the Uniform Money Services Act, amending language that has been inconsistently implemented or interpreted over time.<sup>1</sup>

## Working Group Drafting Process

The Working Group is comprised of representatives from:

- California
- Minnesota
- Ohio
- Pennsylvania
- Texas
- Washington (Chair)

The working group has met weekly since February, discussing the topics identified by the Fintech Industry Advisory Panel. The working group frequently reached consensus, but as with any effort to harmonize state laws, there are several issue areas where differences remain. To move issues forward, the working group employed a majority rules decision making process. Not every state agreed with every recommendation, and as such, the language contained in

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<sup>1</sup> Uniform Money Services Act (amended 2004) available at <https://www.uniformlaws.org/viewdocument/final-act-with-comments-56?CommunityKey=cf8b649a-114c-4bc9-8937-c4ee17148a1b&tab=librarydocuments>.

these draft iterations is not a specific endorsement by any one state. Instead, the language represents the group's best efforts to find common ground, cognizant of the fact that the CSBS Board will make the final policy determinations.

These issues will require insight and perspective from state commissioners and industry alike.

**Any policy areas with dissent among the working group or that may otherwise be controversial are identified in red underlined text.**

## Policy & Outstanding Questions

### Generally

Model law language drafting has focused on three primary policies:

- Regulation must sufficiently protect consumers from harm, including all forms of loss;
- Regulation must enable the states' ability to prevent bad actors from entering the money services industry; and
- Regulation must preserve public confidence in the financial services sector, including the states' ability to coordinate.

### Scope

The model law language should apply to companies operating or seeking to operate on a national scale. Companies that only operate in one state or that are otherwise uninterested in integrated standards should not be subject to a uniform law.

*Outstanding Question:* how should the states bifurcate the applicability of the model law language and existing law? Options include:

- 1) The model law language is adopted as an overlay of existing state law, allowing those interested to transition from a current state license to a multistate license.
- 2) The model law language is inserted into existing state laws as an alternative means of compliance.
- 3) The model law language replaces existing state laws, but states retain their preexisting regulatory requirements for small or single state companies.

## Activity Definitions

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 services are defined, and which persons and activities are exempt state-to-state.

To address this issue, the working group has drafted definitions for:

- Money Transmission
- Money
- Stored Value / Prepaid Access
- Virtual Currency
- Sale of Payment Instruments

The activity definitions – money transmission, stored value, and sale of payment instruments – are designed to apply to those activities that pose a risk to consumers. For each definition, individuals or companies that take, hold, or send customer funds are subject to licensure.

In addition to these definitions, the working group drafted uniform modules for currency exchange and virtual currency. Since some states do not regulate currency exchange or activities involving virtual currency, these areas are drafted in a manner that can be incorporated into the law if necessary.

*Outstanding Question:* how should the states ensure consistent interpretation of definitions?

## Exemptions

The Fintech Industry Advisory Panel recommended harmonizing and making transparent the treatment of common exemptions. As a policy matter, exemptions are appropriate if an activity does not pose a risk to the customer. Other exemptions, however, may have non-traditional methods or different target markets, but risk to consumers or the public confidence remain.

The following chart identifies the common exemptions, communicates the policy position within the draft, and the basic requirements for meeting the exemption.

FIAP-Identified Exemption	Draft Position	Risk-Mitigating Requirement(s)
Agent of the payee	Exempt	Consumer liability is extinguished
Insured prepaid card	Exempt	Consumer funds are insured immediately
Closed loop prepaid access	Exception to Prepaid Definition	Funds not held by intermediary
Payment processors	Exempt (Agent of Payee)	Funds held in regulated institutions
<u>Payroll services &amp; 1099 contractors</u>	TBD	TBD
Agents and service providers of banks	Exempt	Insured deposits
Payment of business taxes	Not Exempt	N/A
Business to business activities	Not Exempt	N/A

The working group reasoned that payment of business taxes should not be exempt because public confidence is eroded when an exempt company fails to pay a business's taxes.<sup>2</sup> The

<sup>2</sup> Most recently, an unlicensed company called MyPayrollHR abruptly closed, with a reported \$35 million in payroll and taxes missing. See <https://www.timesunion.com/business/article/MyPayrollHR-controversy-What-happened->

consequences of missed tax payments apply even if an intermediary loses the funds, presenting a high risk to businesses, including the 30.2 million small businesses employing 58.9 million people.<sup>3</sup>

The working group reasoned that business to business activities should not be exempt because payments between businesses are a crucial underpinning to state economies. As such, public confidence must be preserved by requiring intermediaries that hold funds on behalf of businesses to do so in a safe and sound manner.

*Outstanding Question:* should businesses that only take payor funds after they've sent money to the payee at the payor's instruction (prefunding) be exempt?

## Control

The Fintech Industry Advisory Panel reported that differences in standards and procedures for change in control create significant administrative burden. To address these differences while maintaining the states' ability to prohibit unfit persons from accessing the financial sector, the working group has standardized change of control triggers and the definition of control persons.

### Control Person

The definition of control used in the draft uses common language focused on ownership, power to elect officers and management, and influence over the company's management. A 10% ownership threshold was selected because the Fintech Industry Advisory Panel recommended moving away from the rebuttable presumption of ownership in favor of consistent requirements.

To except passive investors, the definition excludes individuals not employed by the licensee who do not have the power to vote and do not participate in operations and decision making. To operationalize this exception, the working group has drafted a passive investor attestation that will help both industry and regulators recognize which investors cannot participate in the day-to-day operations or otherwise exert control over the company.

Procedurally, these definitions and exception will be implemented through the NMLS's Key Individual Wizard Initiative ("KIWI"), which is designed to automate the identification of control persons based on ownership influence.

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[14425744.php](#). MyPayrollHR is only one of many instances of fraud in the payroll and business tax industry. The largest instance known to CSBS involves over \$133 million of funds embezzled by managers of AccountX Financial Services, LLC. See <https://www.justice.gov/usao-wdtx/pr/remaining-san-antonio-businessman-charged-connection-133-million-real-dollar-loss-fraud>.

<sup>3</sup> See, e.g. Small Business Administration, *2018 Small Business Profile*. Available at <https://www.sba.gov/sites/default/files/advocacy/2018-Small-Business-Profiles-US.pdf>.

For international persons, the working group adopted New York’s minimum background requirements.<sup>4</sup>

### Change in Control

The draft change in control language requires licensees to apply for any change in control and includes a draft checklist for the application. While not complete, the ultimate goal is for the uniform checklist to replace state specific checklists, streamlining the procedure through NMLS.

The working group extensively discussed background checks of control persons. While there is agreement on the need for an FBI background check, **several states have preexisting state background check requirements. Accordingly, the draft requires state background checks. This issue will require further deliberation.**

*Outstanding Question:* how can the states leverage the multistate licensing agreement to remove repetitive licensing practices that do not address a corresponding risk?

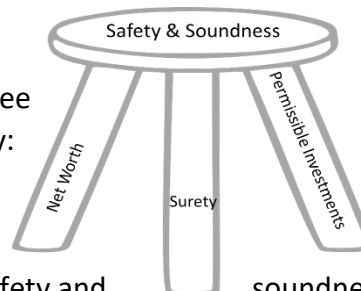
### Financial Condition

During deliberations, the working group sought guidance from the CSBS Non Depository Supervisory Committee (“NDSC”) on (1) whether the model law language should apply to all companies or only those operating on a national basis and (2) whether financial condition requirements should be static or dynamic.

Because the primary issues facing the states are national in scope, the NDSC advised that the model law language should be focused on nationally operating companies. Since these companies are also the largest, the NDSC opined that financial condition should be measured in relation to the company’s balance sheet, meaning requirements should be dynamic or possibly tiered. The Three-Legged Stool and Suspension Bridge reflect different approaches to these policies.

#### Alternative 1: The Three-Legged Stool

The Three-Legged Stool is a streamlined version of the three common safety and soundness features utilized by states today: net worth, permissible investments, and bonding.



#### Net Worth

Net Worth has traditionally served as the primary indication of safety and soundness. However, states vary significantly on the threshold amount of net worth required. To standardize net worth requirements, the working group proposes licensees have a \$100,000

<sup>4</sup> See Information Regarding Control Persons Residing in Foreign Jurisdictions, NY Money Transmitter License, New Application Checklist (Company), pages 13-14. Available at [https://mortgage.nationwidelicencingsystem.org/slr/PublishedStateDocuments/NY\\_Money\\_Transmitter-Company-New-App-Checklist.pdf](https://mortgage.nationwidelicencingsystem.org/slr/PublishedStateDocuments/NY_Money_Transmitter-Company-New-App-Checklist.pdf).

tangible net worth or a net worth equal to 3% of total assets, whichever is higher. The working group further proposes superintendent discretion to increase this amount when necessary based on criteria specified by rule.

#### Permissible Investments

Permissible investments have traditionally served as the primary safety element for consumer funds. As stated in the Uniform Money Services Act Commentary

“Money transmitters are required to maintain a certain level of investments that are equal to the value of their outstanding obligations as a means of protecting individual consumers. This is another safety and soundness requirement designed to safeguard funds received from consumers.”<sup>5</sup>

However, the states are inconsistent in the calculation and treatment of specific assets. The differences in permissible investment requirements can be significant for large money transmitters and makes nationwide compliance difficult. Permissible investments are arguably the single most significant issue in safety and soundness requirements nationwide.

To streamline permissible investment requirements, the working group proposes calculating permissible investments in accordance with GAAP at a level not less than the amount of a licensee’s activity in the United States. The working group further proposes allowing cash, bank receivables, agent receivables less than 7-days old, and federal and state obligations to be subject to no haircuts, and A-AAA investments, commercial paper, and corporate debt subject to a 30% haircut. The working group seeks greater clarity for funds held at foreign banks.

#### Surety Bond

Surety bonds traditionally act as the safety net for consumer loss and the cost of a receivership. While not common, states have had to call on bonds to make consumers whole and manage the dissolution of licensed MSBs.

Public policy surrounding surety bonds can be difficult from a national perspective because the covered liabilities are inherently local. While a company may have significantly more consumer obligations than all state bonds can cover, that does not mean an individual state’s bond does not cover all the activity in that state. For example, a \$500,000 West Virginia bond may be enough to cover West Virginia liabilities even if the company has over \$1 billion in total customer liabilities.

To account for these issues of scale, the working group proposes tying bond requirements to transaction activity. Starting with a \$100,000 minimum for all activity from \$0 to \$5 million, the required bond amount would increase \$100,000 for every \$5 million up to \$45 million. At \$45

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<sup>5</sup> Uniform Money Services Act, Section 701, Maintenance of Permissible Investments Commentary, p. 60. Available at [uniformlaws.org](http://uniformlaws.org).

million, the bond amount required will be \$1 million. The working group also proposes commissioner discretion to increase bond amounts up to \$7 million.

Summary

Altogether, the Three-Legged Stool proposal covers the following:

Category	Metric	Proposed Threshold(s)
<b>Financial Condition</b>	Net Worth	Greater of \$100,000 or 3% of Total Assets
<b>Surety Bond</b>	\$100,000 bond per \$5 million in transaction volume	Standard: \$100,000 up to \$1 million Discretionary: up to \$7 million
<b>Permissible Investments</b>	Transmission Liability	U.S. Liabilities
	0% Haircut	Cash, bank receivables, agent receivables less than 7-days old, US & state obligations
	30% Haircut	AAA-A investments, commercial paper, corporate debt or bonds

Alternative 2: The Suspension Bridge

The Suspension Bridge is a melting pot of the Liquidity Coverage Ratio and the EU’s Second Payment Services Directive approaches to safety and soundness, creating a ratio-based financial condition requirement that dictates how consumer funds are to be safeguarded. Because the concept is new, the Suspension Bridge is presented in a PowerPoint presentation, not draft statutory language. The following summary is designed to provide context to the PowerPoint presentation.

In short, the Suspension Bridge relies upon the size of a company’s tangible assets compared to total liabilities to dictate how customer funds can be held – the larger the buffer, the more types of assets available. Underpinning this approach is a policy based on a company’s ability to absorb losses:

- 1) A company must, at a minimum, be able to absorb a 5% loss;
- 2) A company should, at a minimum, be able to absorb a 15% loss;
- 3) The ability to absorb a 50% loss provides the assurance needed to permit companies to safeguard customer funds using assets that are not risk-free.

Tangible Asset Buffer:  $\text{Tangible Assets} / \text{Total Liabilities} - 1.00$

The proposed “Tangible Asset Buffer” is a measure of the tangible assets in excess of total liabilities, which will be available in the event of a loss or reduction in assets or asset value. It is

measured by dividing tangible assets by total liabilities, then subtracting 1.00.<sup>6</sup> The buffer form is used for discussion purposes to better describe the amount of funds available to cover a loss.<sup>7</sup>

For example, a company with \$1,500,000 in tangible assets and \$1,000,000 in total liabilities has a 50% Tangible Asset Buffer. If a loss of \$250,000 occurs, the company would be able to absorb the loss without incurring more debt or nearing bankruptcy.

Tangible assets are used because a small minority of companies have a substantial amount of goodwill and other intangible assets on their balance sheet. By using tangible assets, the measure only includes assets that are physical or otherwise have a defined monetary value.

### Safeguarding Consumer Funds: High Quality Liquid Assets

Currently, many states have permissible investment requirements designed to make consumers whole in the event of a loss or failure. Permissible investments often have a risk-based haircut, meaning only a certain percent of the dollar total “count” for riskier assets. For example, agent receivables may have a 30% haircut, which means only 70 cents of every dollar owed to the principal by an agent are considered permissible investments. As currently constructed, this risk analysis focuses on the asset alone, not the financial health of the company.

Without matching the permissible investment risk to financial condition, a company in poor financial health can keep customer funds in risky assets, increasing the danger of funds not being available when needed. This scenario is not theoretical. In 2008, MoneyGram held significant portions of its permissible investment portfolio in mortgage backed securities. As these securities declined in value, MoneyGram simultaneously experienced a liquidity crisis and became non-compliant with prudential requirements.<sup>8</sup> MoneyGram’s balance sheet was unable to handle a decline in asset value and was poised to lose significant sums of customer funds before a bailout investment by Thomas H. Lee Partners and Goldman Sachs.<sup>9</sup>

To address this problem, the Suspension Bridge proposal tiers the types of permissible investments a licensee can use with its ability to cover losses. The tangible asset buffer is used as a proxy for a company’s ability to absorb losses. The buffer tiers have corresponding permissible assets, which themselves are subject to risk-based adjustments adapted from the liquidity coverage ratio.

The liquidity coverage ratio is a risk-weighted liquidity system designed to ensure a large bank can meet short term obligations. Like risk-based capital or permissible investment haircuts, the liquidity coverage ratio uses risk-based haircuts and asset caps designed to prevent banks from relying too heavily on risky

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<sup>6</sup> The proposed “Tangible Asset Ratio” is based on the debt ratio, which measures a company’s leverage. Aligning the debt ratio with the proposed policy, the inverse calculation is used to focus on the tangible assets available to mitigate a reduction in total assets.

<sup>7</sup> A 1.15 tangible asset to total liabilities ratio is the same as a 15% tangible asset buffer.

<sup>8</sup> See MoneyGram International, Inc., Annual Report, p. 9 (Form 10-K) (March 25, 2008) (“In connection with the [recapitalization], we sold certain investments at a realized loss of \$260.6 million. As a result of these portfolio sales, we were not in compliance for a brief period of time with the minimum net worth requirements of the states in which we are licensed to conduct our money transfer and other payment services businesses, as well as certain other requirements of one state.”).

<sup>9</sup> See, e.g. <http://www.thl.com/newsroom/press-release?year=2008&id=1442>.



assets to cover losses or short-term liabilities. In this regard, it is the perfect proxy for permissible investments. The haircuts and asset cap requirements for banks are outlined in the presentation alongside proposed adaptations for money transmitters.

### Safeguarding Customer Funds – Prohibition on Commingling

Permissible investments serve a protective function for customer funds. Additionally, permissible investments are an implicit restriction on how customer funds can be used: 100% of customer funds must be held in specified assets. The European Union makes this implicit restriction explicit:

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*. . . funds shall not be commingled at any time with the funds of any natural or legal person other than payment service users on whose behalf the funds are held . . .*<sup>10</sup>

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By similarly prohibiting commingling, the states would be in a position to provide added flexibility for protecting consumer funds. For example, the European Union permits companies to bond 100% of customer funds, foregoing the equivalent of permissible investments. This alternative to permissible investments may be useful for startups and smaller companies, while still ensuring customers can be made whole in the event of failure. In the context of the proposal, this is referred to as “flexible support.”

### Rethinking Bonds for Large Licensees

For the largest licensees, surety bonds do not provide the kind of protection envisioned in traditional money transmitter laws. Even if the nationwide bond requirement were doubled (from \$50 million to \$100 million), the amount would only cover pennies on the dollar for the liabilities of the largest companies. As such, permissible investments are the single most important aspect of protecting consumer funds.

Accordingly, the Suspension Bridge proposal repurposes surety bonds for the largest institutions. Relying on the tangible asset buffer and corresponding high-quality liquid assets for consumer protection, the surety bond is used to cover the costs of administering a receivership. In bankruptcy, high quality liquid assets will only secure consumer funds if they can be returned. Since the largest institutions are complex, it is expected that a receiver will be necessary to wind down the company. The working group seeks feedback on how to calculate the appropriate amount.

### Protecting Safeguarded Assets in Bankruptcy

State permissible investment laws typically protect consumer funds from creditors in bankruptcy. For example, California creates a springing trust to protect eligible securities (permissible investments) in bankruptcy:

Eligible securities, even if commingled with other assets of the licensee, are deemed to be held in trust for the benefit of the purchasers and holders of the licensee’s outstanding payment instrument and stored value obligations, and all senders of outstanding money

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<sup>10</sup> Payment Service Directive, Title II, Chapter 1, Section 1, Article 10. Available at <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32015L2366&from=EN#d1e2365-35-1>.

received for transmission, in the event of bankruptcy or receivership of the licensee, or in the event of an action by a creditor against the licensee who is not a beneficiary of this statutory trust.

This protection is needed to prevent consumer funds from entering the bankruptcy estate as unsecured assets. However, these protections are untested, and there is precedent striking down springing trusts in bankruptcy court. More research is needed on this issue, but solutions may involve better aligning trust requirements with bankruptcy exceptions and/or a change in federal law. Additionally, if a money transmitter used customer funds to pay debts, it would be considered a criminal act. Appropriately clarifying this crime may prevent a bankruptcy court from discharging consumer funds in a manner that would be illegal for the debtor.

Considering the shortcomings of the Three-Legged Stool and shift required to adopt the Suspension Bridge, significant discussion is required among the states and industry. CSBS envisions discussions beginning in September focused on gathering feedback, followed by in-depth policy discussion.

## Coordination

The states have made tremendous progress coordinating across state lines. Between the NMLS, Nationwide Cooperative Agreement<sup>11</sup> and Protocol<sup>12</sup> for MSB Supervision, and Multistate MSB Licensing Agreement,<sup>13</sup> there is a large body of interstate work proving the states can come together to regulate MSBs more efficiently and more effectively.

To facilitate interstate coordination, the model law language includes implementation language designed to provide the legal framework for states to work together and adopt consistent standards and processes. The language is adapted from current state laws focused on permitting interstate supervision and creating parity between national and state chartered banks. Utilizing these models provides the states with the legal authority to adjust to new products, risks, processes, and technological capabilities in a coordinated manner. The relevant draft language focused on parity is as follows:

In order to support uniformity between states, notwithstanding any other provision of law, if the commissioner finds that any provision of other state money services laws, regulations, guidance, interpretations, orders, processes, or policies applicable to licensees is substantively different from the provisions of this code, or would more clearly establish requirements within the commissioner's discretion, the commissioner may by regulation, guidance, interpretation, order, process, or policy make such a provision of another state's money services law, regulation, guidance, interpretation, order, process, or policy applicable to licensees.

The provision includes guidance, interpretations, orders, processes, or policies because states have different legal mechanisms for adopting legal and policy positions.

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<sup>11</sup> Available at <https://www.csbs.org/sites/default/files/2017-11/MSB-CooperativeAgreement010512clean.pdf>.

<sup>12</sup> Available at <https://www.csbs.org/sites/default/files/2017-11/MSB-Protocol010512.pdf>.

<sup>13</sup> See, e.g. <https://www.csbs.org/23-states-join-multistate-licensing-agreement-financial-services-companies>.

## Next Steps

After a public notice and comment period, CSBS will consider suggestions and make changes to the draft as necessary. Once approved, the model law language will be used as a policy foundation for all other aspects of MSB regulation and supervision: streamlining implementation, process, and supervision based on the standards adopted in the model law.

Please contact [modelpaymentslaw@csbs.org](mailto:modelpaymentslaw@csbs.org) with any questions, suggestions, or comments.