THE CONFERENCE OF STATE BANK SUPERVISORS

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REENGINEERING NONBANK SUPERVISION

Chapter Four: Overview of Money Services Business

October 2019

About This Paper

This paper, *Reengineering Nonbank Supervision*, serves two primary purposes. First, as a stakeholder awareness document covering state supervision of the nonbank marketplace, and second, as a change document or roadmap to assist state supervisors in identifying the current state of supervision and making informed changes to state supervisory processes. The paper is comprised of several standalone chapters that together will cover the industry supervised by state nonbank financial regulators, the existing system of supervision for nonbanks and the challenges and opportunities for state supervisors in "reengineering" that system.

The chapters provide a broad overview of the industry participants and how they are regulated by state nonbank supervisors. We combine these sometimes unlike participants into a single industry of nonbanks due more to jurisdictional coverage and supervisory constructs than similarities between the participants themselves. The common theme is that all of these participants provide or facilitate consumer products and services and fall under the authorities granted to nonbank supervisors.

State financial regulators are the primary regulators of nonbanks operating within the United States. Together, they have forged a series of initiatives, collectively known as CSBS Vision 2020, to modernize nonbank licensing and supervision. This paper contributes research and engages discussion on possible actions that might be taken.

Chapters to Date

Chapter 1 – Introduction to the Nonbank Industry
Chapter 2 – Overview of State Nonbank Supervision
Chapter 3 – Overview of Nonbank Mortgage

Acknowledgements

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Chapter Four

Overview of the Money Services Business

Key Findings

- The money services business (MSB) is a $1.4 trillion sector that dates back to the mid-1800s, comprised of money transmission, the sale of payment instruments, prepaid or stored value cards, check cashing and foreign currency exchange.
- Money transmission is large, growing and increasingly fintech-based. According to data collected by the Nationwide Multistate Licensing System (NMLS), money transmission represents roughly 60 percent of all MSB transactions…from 2017 to 2018, the dollar volume of money transmission transactions increased by 57% to $851 billion…and since 2010, 73% of new entities rely on an internet business model versus agent-based.
- Roughly 55% ($749 billion) of all MSB transactions in 2018 were fintech-based, per NMLS data.
- For more than a century, state financial regulators have had exclusive prudential jurisdiction over MSBs. State supervision involves licensing, examination, enforcement and complaint handling. Regulatory requirements focus on consumer protection, financial safety and soundness and adherence to the Bank Secrecy Act/Anti-Money Laundering federal law (BSA/AML). In supervision, state regulators coordinate with each other as well as the federal agencies CFPB and FinCen/IRS.
- The states have been working to improve the efficiency and effectiveness of MSB licensing and supervision, which benefit regulators and industry alike.

Money services businesses (MSBs), and specifically money transmitters, play a vital role in providing financial services to consumers and small businesses across the country and internationally. Countless Americans use MSBs every day to pay bills, purchase items online or send funds to family members and friends domestically and abroad. MSBs are especially integral to those less likely to use traditional banking services. Over one-quarter of U.S. households use nonbank financial institutions, including money transmitters.[1]

The term MSB is very broad and describes many types of business models. Further complicating the description of MSB is the diversity of product offerings some MSBs provide: a check casher might issue money orders, a bill payer might issue prepaid cards, and a money transmitter might also provide a stored value product. However, except for check cashers, all MSB activities are subject to similar financial, consumer and procedural requirements. This makes sense: check cashers provide customers with funds, while the other activities involve customers giving the company funds.

[1] U.S. Department of Treasury, National Money Laundering Risk Assessment, June 12, 2015.

Pursuant to the Uniform Money Services Act (UMSA), MSBs are nonbank entities that do not accept deposits or make loans like traditional banks or financial institutions. Rather, they provide alternative mechanisms for persons to make payments or to obtain currency or cash in exchange for payment instruments. MSBs engage in the following types of financial activities:

- money transmission (e.g., money transfers)
- the sale of payment instruments (e.g., money orders and traveler's checks)
- prepaid or stored value (e.g. prepaid cards and digital wallets)
- check cashing
- foreign currency exchange

While all states except Montana have passed laws covering MSBs, no two laws are identical, and some lack basic similarities. Even the 12 states and territories that adopted the UMSA have differences or different interpretations of the law. All of this makes describing the regulation and supervision of MSBs complex.

Here we use the term MSB to mean state supervised nonbanks providing the services of money transmission and check cashing. Money transmission will be used broadly, encompassing funds transfers, sale of payment instruments, prepaid and stored value.

Money transmission is the selling or issuing of payment instruments, stored value, or receiving money or monetary value for transmission.

- Money transmitters conduct the business of accepting and transmitting funds.
- Sellers of payment instruments, sometimes called check sellers, conduct the business of selling checks, drafts, money orders or other commercial paper that consumers and businesses use for transmission of money or payment for goods and services (e.g., payment of a utility bill).
- Prepaid/stored value providers hold monetary value evidenced by an electronic record, such as a prepaid card or a digital wallet.
- Foreign currency exchangers exchange the money of one government for money of another government.
- Check cashers are businesses that cash checks for a fee, including payroll checks, personal checks, government checks, income tax refunds, insurance checks, money orders and cashier's checks.

FITTING VIRTUAL CURRENCY INTO THE LANDSCAPE

Virtual currency is a digital representation of value used as a medium of exchange, a unit of account, or a store of value but does not have legal tender status as recognized by the U.S. government. Virtual currency does not include the software or protocols governing the transfer of the digital representation of value. Virtual currency does not include stored value redeemable exclusively in goods or services limited to transactions involving a defined merchant, such as rewards programs.

When virtual currency is used in lieu of money (fiat currency) for any of the activities included under money transmission, the activity is typically still considered money transmission.

State Regulatory Requirements for Virtual Currency Activities, CSBS (Sept. 15, 2015)

History of MSBs

Money Transmission

The story of money transmission is one of westward expansion and trans-continental transport. As the U.S. population expanded west, the telegraph followed. Ten years after completing the first transcontinental telegraph, Western Union expanded its telegraph service, starting a money transfer business in October 1871. (The Western Union Company, 2006) To make this business model work, the company invented the modern agent model: since it owned the telegraph lines which ran along the railroad tracks, they used the station masters to perform money transfer services. The station masters were independent businesspersons with cash lockboxes who could conduct the transactions and settle with Wells Fargo afterward. Today, agents such as convenience stores perform this "agent" function for licensed MSBs.

Coastal populations also needed a way to send money across oceans, leading to money transmission by a different means around the turn of the twentieth century. Known as immigrant banks, steamship operators and their staff would take funds from immigrant populations back to Europe and Asia.

While some states considered "immigrant banks" to be engaged in illegal deposit taking,[2] others created a framework for protecting consumers from malfeasance. Massachusetts, New Jersey, New York and Ohio had special laws regarding "immigrant banks." While all four states required the filing of a bond,[3] New Jersey's law most resembled today's money transmission laws:

> "The law of New Jersey (in effect July 4, 1907; amended in 1909) prohibits any person or corporation from transmitting money to foreign countries or buying or selling foreign exchange or receiving money on deposit to be transmitted to foreign countries, without a certificate of authority from the commissioner of banking and insurance. It further provides that nothing in the act shall be construed as authorizing any such person or corporation to receive money on deposit for any other purpose than that of transmission abroad."

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[2] Delaware, Nebraska, Nevada, North Dakota, Oklahoma, Rhode Island and Wisconsin considered transmission by steamship to be illegal private banking. In a letter dated Sept. 24, 1909, the Rhode Island commissioner of banks relayed the following to the Senate's Immigration Commissioner: "Immigrant steamship agencies and others doing a banking business come under the head of unauthorized banking, and the business is prohibited, but owing to the clannishness of foreigners it is extremely difficult to convict these people. There are about a dozen individuals who, I believe, are receiving deposits, principally among the Italians, but they all deny doing a banking business, as they are familiar with the law which prohibits their receiving deposits." Reports of the Immigration Commission, 61st Congress, 3d Session, Document No. 753, p. 318 (Dec. 5, 1911). The report also references several states where such "banking business" was likely a violation of existing state law: California, Colorado, Florida, Idaho, Indiana, Kansas, Missouri, New Hampshire, Oregon, South Dakota, West Virginia and Wyoming. Colorado is referenced as providing regulation and supervision, whereas the "immigrant institutions" in Indiana and Missouri exist as "full-fledged banking concerns without apparent control or regulation, and seemingly in open violation of law." Id. At 318.

[3] Massachusetts and New Jersey required bonds be filed with the state bank commissioner. New York required filing with the comptroller, and Ohio required filing with the state auditor.

The report continues to identify modern money transmitter requirements:

> "The New Jersey certificate of authority amounts to a license, which must be renewed annually, and for which a fee of $10 is paid. It is granted only upon the filing of a written application under oath on an approved form, setting forth the location of the office or officers where the business is to be carried on and the country or countries to which it is proposed to transmit money."

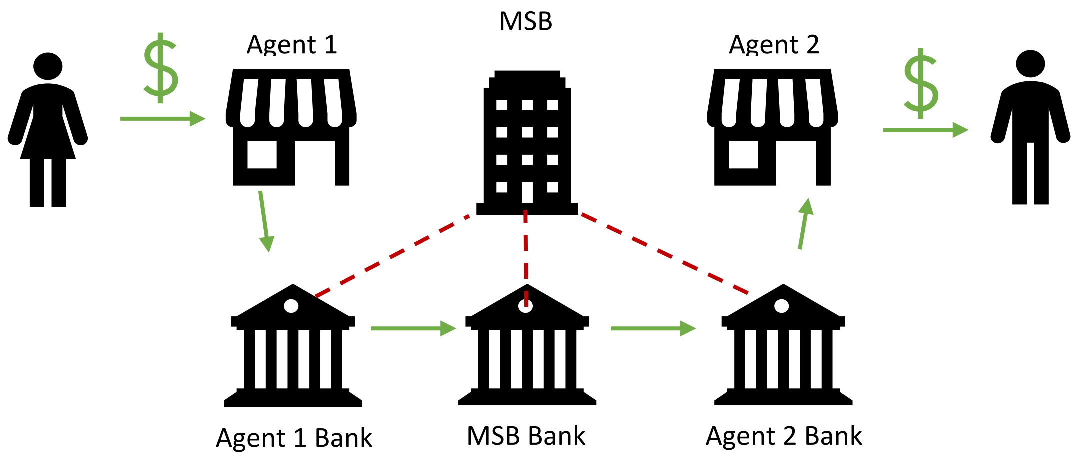
Massachusetts, New York and Ohio conditioned the activity on steamship and railroad ticket sales, which is described as less effective than New Jersey's focus on the transmission activity. Like today, the regulator that focused on the financial activity, not the underlying technology, is described as historically more effective.

Other early entrants to money transmission shaped the market. In addition to Western Union, American Express was founded in 1850 by Henry Wells and William G. Fargo of Wells and Fargo, as well as others. American Express was an early innovator of MSB products such as money orders and traveler's checks. (Encyclopaedia Britannica, n.d.) MoneyGram International can trace its roots back to 1940, with the founding of Minneapolis-based Travelers Express Co., Inc. Under parent company Viad Corp., Travelers Express quickly became one of the world's largest processors of money orders and a key player in the electronic payments industry, with ties to big-name businesses including bus company Greyhound Corp. and soap maker The Dial Corp. (MoneyGram, n.d.)

As the banking industry evolved, so did the money transmission industry. Today, there are two primary business models: agent-based and internet-based. The primary difference between the two models is cash – while the agent-based model is a means of transmitting cash, internet-based models are cashless. Both models primarily rely on banks to send funds.

The agent-based business model is focused on transmitting cash between locations. Money transmitters accomplish cash transmissions through a series of agents that take customer cash, and a series of bank accounts used to send the cash to the money transmitter and other agent locations. When an agent, e.g. the corner store, takes $500 from a customer to send to a family member, these funds go into the agent's bank account, are swept into the money transmitter's bank account and then sent to a paying agent's bank account. The paying agent then gives cash to the intended recipient. The money transmitter is effectively acting as a messenger and accountant, debiting and crediting accounts to accomplish the transfer.

Agent Based Model

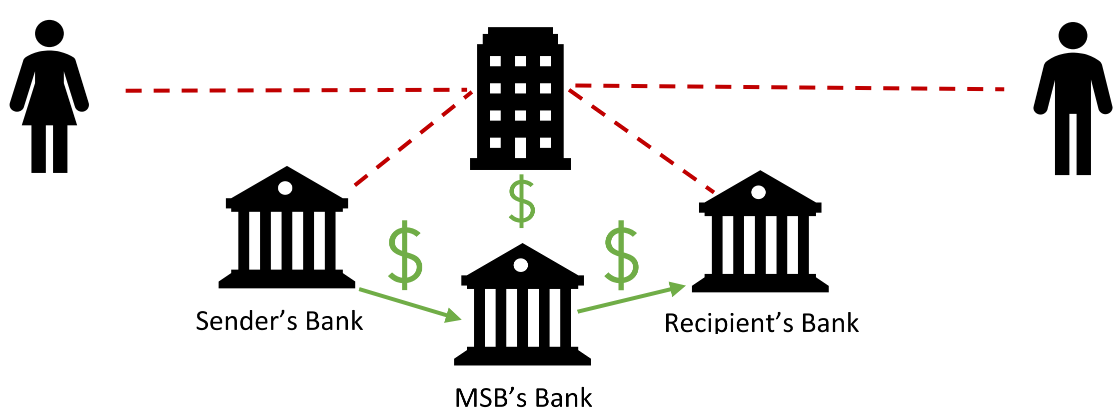


For the purposes of illustration, the above example includes three different banks. However, money transmitters will often require agents to deposit funds directly into the MSB's bank, which allows the money transmitter to better monitor risk, sweep funds and keep customer funds segregated from the funds of the agent.

A similar process is used for sale of payment instruments (e.g. money orders), except instead of money flowing through the system of agents and banks, the customer holds a negotiable instrument he or she can give to any designated third party. The third party then cashes or deposits the payment instrument, and settlement occurs between the banks.

The internet-based business model is focused on transmitting money between bank accounts, primarily through ACH transfers. For example, an online wallet is funded by a customer linking his or her bank account, then instructing the money transmitter to debit a specific amount from the bank. The debit can be used to fund a balance held by the money transmitter or performed in conjunction with a transfer where the debited funds are credited to another customer's account. Each transfer is typically executed via ACH, batching the funds with other inter-bank transactions.

Internet Based Model



Some business models use a combination of both agent and internet-based business models. For example, prepaid cards can be funded at a store with cash or online via a bank transfer. Similarly, many traditional agent-based money transmitters are developing internet-based business models, providing customers with the ability to fund accounts with cash or through bank transfers.

Check Cashing

While there is little official history of the commercial check cashing industry, it is believed to have emerged in the United States in the early 1930s as a niche business for processing payroll and government-aid checks. Interviews with industry and regulator subject matter experts have helped CSBS better understand the origins and growth of the industry.

When the payment of salaries changed from cash to paychecks, merchants started cashing checks for consumers without bank accounts. The process involved consumers establishing a relationship with a check casher, providing some background information and endorsing the back of their paycheck. In turn, the check casher would give the consumer the amount of the check minus a fee. The casher then presented the paycheck to the employer's bank for the funds to be transferred to the check casher's bank. Due to the large amount of bank failures in the late 1920s and early 1930s, many customers were reluctant to deposit checks into banks, preferring instead to cash checks locally for a small fee.[4]

However, with the establishment of the Federal Deposit Insurance Corp. (FDIC) in 1934, public confidence in banks was largely restored, and growth of the check cashing industry remained modest for decades. There was no major boost in the industry until the deregulation of banks in the 1980s. Furthermore, the rapid growth of electronic banking, particularly direct deposits, presented a major challenge to check cashing in the mid-1990s.

According to the Financial Service Centers of America (FiSCA)[5], the industry association representing the check cashing industry, "[t]he growth of the industry was stimulated, in part, by the passage of the Bank Deregulation Act of 1980, which removed deposit rate ceilings and led to explicit pricing for bank deposit services. Faced with a new banking environment, consumers demanded increased convenience and lower costs in fulfilling their financial service needs. As a result, community-based check cashing centers which provide more convenient access to financial services became increasingly utilized. In 1987, the National Check Cashers Association was established to represent the members of this growing industry." [6]

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[4] The Future of Check Cashing, National Check & Currency (March 10, 2017). "While the exact origin of the check cashing industry is debated, most agree that it started in the 1930s. Several phenomena encouraged the formation of check cashing businesses. First, the financial ramifications of the Great Depression created a banking crisis and left customers scrambling to find payment services. Second, as businesses transitioned from cash payrolls to payroll checks, check cashing services became essential."

[5] www.fisca.org

[6] In 2000, the association changed its name to FiSCA.

The ability to offer a wide range of services became critical for check cashing organizations, with most offering money orders, bill payment and other convenience services beyond check cashing. Check cashers are often closely associated with payday lending or small loan companies and many companies offer both services. According to HG Legal Services, "Check cashing is a more traditional form of very short-term loan. Some institutions will allow you to write a check to that entity and receive cash. This is a sort of throwback to a time when more transactions took place at the register via check."[7] In fact, the state of Washington requires payday lenders to first hold a check casher license before receiving an "endorsement" to conduct payday lending (RCW 31.45.073).

The physical nature of checks and other consumer transactions leads to most check cashers being local, brick and mortar operations. According to FiSCA, in addition to MSB activities, this segment of the financial services industry provides:

- Small dollar, short-term loans (e.g. payday advances)
- ATM access
- Government benefit & payroll payments
- Tax preparation
- Deposit acceptance services
- A number of other financial and consumer services

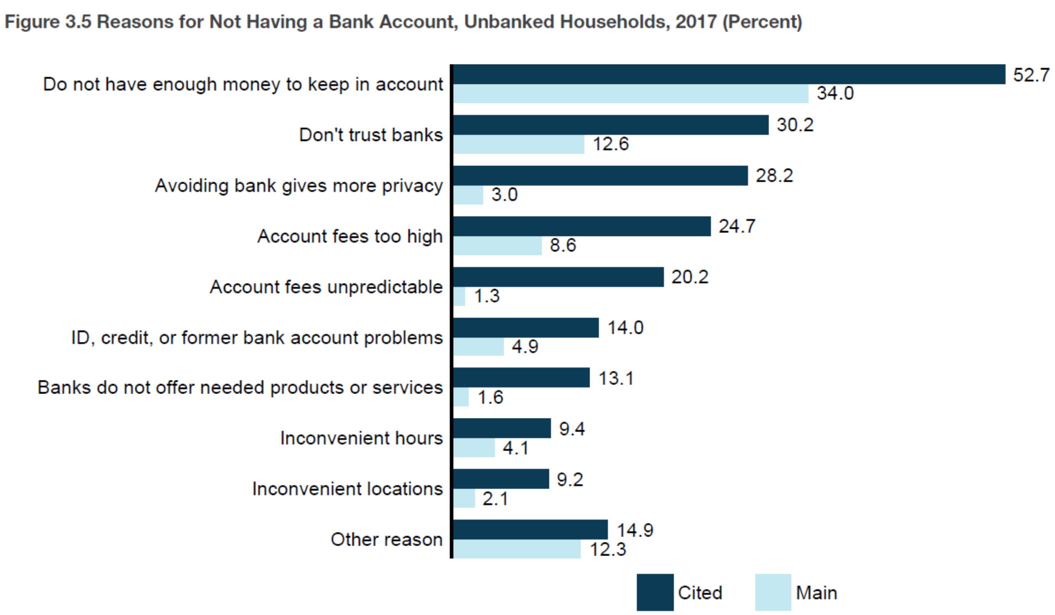
The physicality of the industry is observed in MSB call report fintech trends where we can see that the check cashing industry has not gone digital.

The FDIC's 2017 National Survey of Unbanked and Underbanked Households shows that 1.9% of U.S. households use check cashers to cash checks and 6.9% pay bills with money orders. However, as a percentage of unbanked households, these numbers increase to 23.7% and 39.1%, respectively. This same report explains the primary reasons for unbanked households not having bank accounts, below.

WHY DO CONSUMER USE CHECK CASHERS?

People who use check cashers come to the physical store frequently – once a week or more. Each individual transaction doesn't cost the customer very much - $1.50 to pay a bill, 89¢ to buy a money order – but these sums add up … Check cashers make their money by paying a lot of bills, selling a lot of money orders, cashing a lot of checks. [John Coleman, President of RiteCheck explained customer motivation], "Let's say a customer gets paid on Friday. If he brings his check to us, he gets his money immediately. He can pay his bills right away, go food shopping over the weekend. If he goes to the bank, his check won'[t clear until sometime the next week. He'll be late on his bills. And if he writes a check and it hits his account before the check he deposited clears, he'll be hit with an overdraft fee for more than thirty dollars – much more than the fee he would have paid to us." The Unbanking of America, Lisa Servon.

[7] https://www.hg.org/legal-articles/what-are-the-laws-regarding-check-cashing-and-payday-advances-35466



Source: FDIC 2017

Size and Scope of the MSB Industry

MSBs are required to file "call reports" in the Nationwide Multistate Licensing System (NMLS), which are quarterly data submissions reflecting financial condition, transactions and some compliance information. For 2018, this data reflected a total of over $1.4 trillion dollars in MSB transactions, the majority within the United States. The table below provides transaction information for each product type for the years 2017, 2018 and first half of 2019.

Product	2017	2018	Annual Change	2019 Q1 & Q2	Annual Change
Money Transmission	$759 billion	$851 billion	12%	$619 billion	57%
Payment Instruments	$190 billion	$175 billion	-8%	$89 billion	2%
Stored Value	$234 billion	$296 billion	26%	$189 billion	40%
Check Cashing	$17 billion	$14 billion	-16%	$5 billion	-40%
FIAT Currency Exchange	$4 billion	$5 billion	22%	$2 billion	9%
Virtual Currency	$129 billion	$70 billion	-46%[8]	$35 billion	-27%
Total	$1.3 trillion	$1.4 trillion	6%	$940 billion	39%

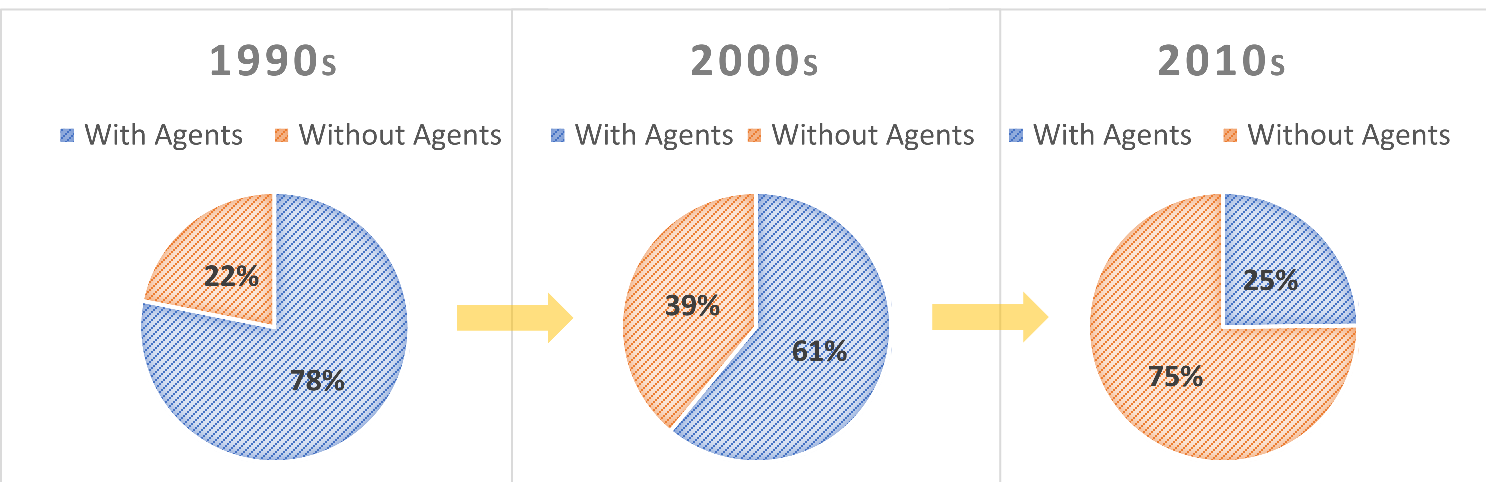
Source: NMLS Call Report Data

[8] Swings in virtual currency dollar volume reflect both the volatile nature of cryptocurrency values as well as new companies reporting to NMLS.

MSBs and Fintech

Moving money across continents and oceans inherently requires technological innovation. Historically, MSBs deployed advanced technology as far back in time to telegraph cables and transporting money via the steam engine. In the modern sense, MSBs are arguably the first fintechs, leveraging technology to create new business models, new delivery channels, automated decisions and partnerships with traditional banks. As recently as 1999, consumers' payment options were solely limited to bank products (e.g. checks, credit/debit cards or wires) or agent-based money transmission and money orders. Today consumers are spoiled for choice with consumer-friendly products accessible on phones and computers because MSBs applied new technologies to existing bank infrastructure. This has made many day-to-day transactions easier for Americans, from paying the bill at a restaurant to sending money across the globe.

NMLS data reflect the dynamic shift that has occurred in the money transmission industry over the past decade. Of the 64 currently operating licensees that were formed in the 1990s, 78% utilize an agent-based business model, where humans facilitate a cash transaction. Since 2010, conversely, 75% of the 133 newly formed companies utilize a business model *without* agents.



The impact on the market by these firms has been astounding. Using NMLS data, CSBS can put parameters around fintech companies. Using conservative identification parameters, fintechs collectively accounted for more than 55% of all transaction volume in 2018.

MSB Fintechs by the Numbers

Product	2017 Fintech Volume	2018 Fintech Volume	Change
Money Transmission	$ 246 billion	$ 426 billion	73%
Sale of Payment Instruments	$ 3.3 billion	$ 3.5 billion	6%
Stored Value	$ 189 billion	$ 255 billion	35%
Checks Cashing	$ -	$ -	-
Currency Exchange	$ 126 million	$ 482 billion	284%
Virtual Currency	$ 127 billion	$ 63 billion	-50%
Total	$ 565 billion	$ 749 billion	33%

When compared to the market as a whole, fintech business models are now the dominant means of transmitting money.

	2017	2018	Change
Total Fintech $ Volume	$ 565 billion	$ 749 billion	33%
Total Industry Volume	$ 1.3 trillion	$ 1.4 trillion	6%
Fintech % of Total Industry Volume	43%	53%	10%

This means that for every $1 transmitted in the United States, 53 cents would have been sent via fintechs. This is a substantial industry change and a small timeframe for it to have occurred.

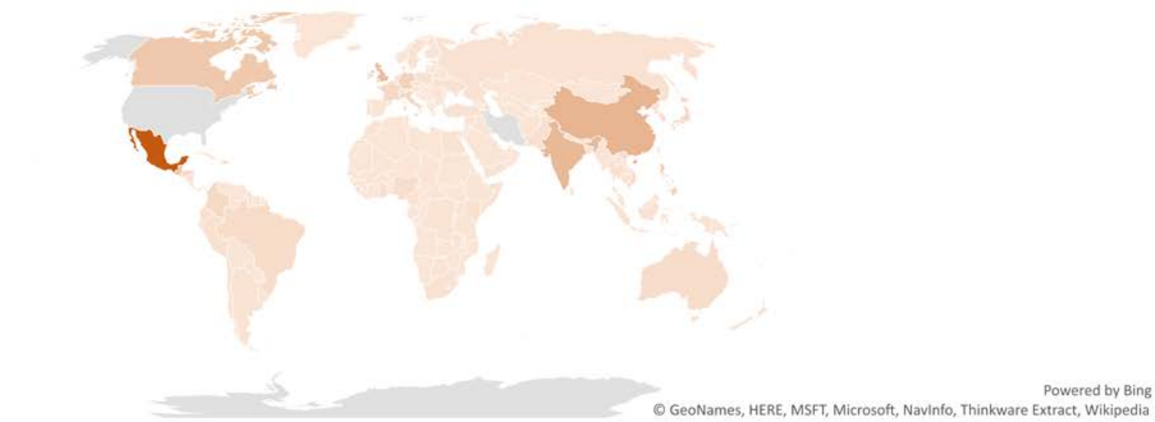
Foreign Money Transmission

Foreign money transmissions, or remittances, are an important source of money to families or business interests abroad. In 2018, the states began collecting call report information that identifies transmission destination and amount. CSBS qualifies that this data is new and based on the actual, unaudited company reports into NMLS. Although NMLS does not currently track U.S. incoming transactions, reporting by the Pew Research Center in 2017 provides information on remittances coming into this country.

The amount of money sent from the United States to other countries far outweighs the amount of money being sent to the United States. In 2018, nonbank transmissions to foreign countries totaled approximately $216 billion, while inflows to the United States totaled $6.6 billion,[9] as measured by the Pew Research Center in 2017. While these numbers are significant, U.S. outflows to foreign countries totals only 15% of all U.S. money transmission, meaning that approximately $1.2 trillion of the $1.4 trillion U.S. transmission market in 2018 was transmitted domestically. (See Size and Scope of the MSB Industry above.)

The maps below provide a visual of where remittances go (NMLS map) and where they are sent (Pew map). In each map, the darker countries receive/send greater total volume. Below each map is provided a table detailing transmission activity for the largest countries with the U.S.

NMLS 2018 Remittances: U.S. to Other Countries

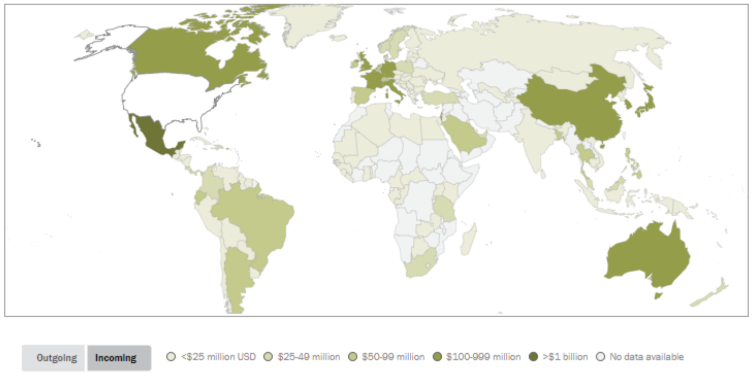


Remittances sent to United States from ...

Country	$
Mexico	$1,774,000,000
Canada	$662,000,000
United Kingdom	$465,000,000
Puerto Rico	$395,000,000
Germany	$307,000,000
Australia	$188,000,000
Israel*	$168,000,000
South Korea	$150,000,000
China	$149,000,000
Italy	$126,000,000
Japan	$125,000,000
France	$113,000,000
Bangladesh	$94,000,000
Thailand	$84,000,000
Ecuador	$82,000,000
Switzerland	$80,000,000
Spain	$77,000,000

Remittance flows worldwide in 2017

$6,621,000,000 in remittances was sent to United States from other countries in 2017.



[9] https://www.pewresearch.org/global/interactives/remittance-flows-by-country/

State MSB Supervision

Although check cashing is federally defined as a money services business, states generally supervise check cashing/selling separate from money transmitters. As such, supervision of check cashing is addressed separately from money transmission in this section.

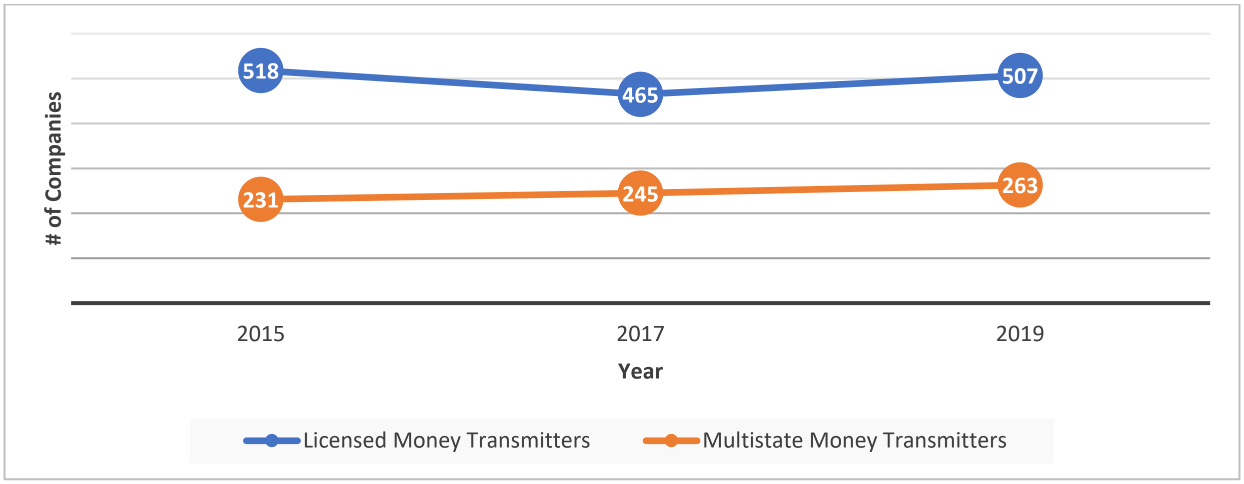
Money Transmitter Supervision

The states have held exclusive prudential jurisdiction over MSBs for over a hundred years. State supervision of MSBs began at the turn of the twentieth century when states began protecting their residents' funds as immigrant populations sent money by steamship back to Europe and Asia. The earliest state money transmitter laws that mirror today's laws date back to 1907.

State MSB supervision is based around licensing, examination, enforcement and complaint handling. State supervision approaches are discussed fully under *Chapter Two – Overview of State Nonbank Supervision*. In this section the elements of supervision of MSBs are covered specifically. State regulatory requirements are focused on consumer protection, safety and soundness and adherence to Bank Secrecy Act and Anti-Money Laundering ("BSA/AML") requirements. Each requirement is enforced through state supervisory programs (The State of State Money Services Businesses Regulation & Supervision, CSBS, May 2016).

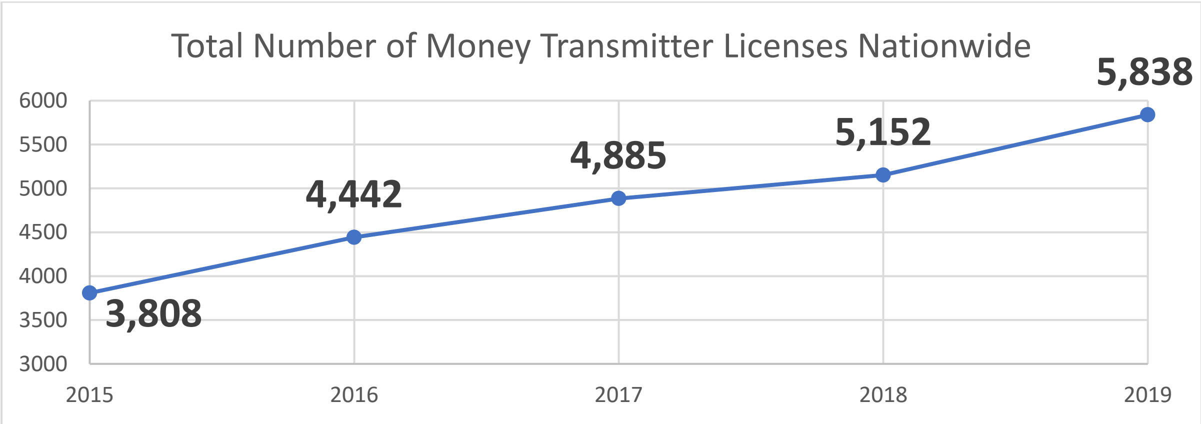
Licensing

In terms of company numbers, money transmitters are a smaller nonbank industry segment. From 2015 to 2019, the industry averaged about 500 total companies, about half of which operate in multiple states. However, company numbers alone belie the breadth and market impact of money transmitters as is discussed below.



Source: NMLS

A smaller percentage of the companies operating in multiple states operate nationwide. In the first quarter of 2019, a total of 71 companies operated in 40 or more states. While this number is small compared to banks or mortgage companies, it is almost doubled from the 37 companies operating in 40 or more states in 2015. This reflects a growing trend – while the number of companies has remained relatively small, the number of licenses per company has increased drastically.



Source: NMLS

In 2015, all money transmitters together held 3,808 licenses. This number has increased by over 2,000 licenses since 2015, reflecting a 53% increase over five years. Since the total number of money transmitters at any given time is comparatively stable, it stands to reason that existing companies are expanding their geographic footprints by obtaining licenses in more and more states. This is reflected in both the growth of nationally operating companies (91% growth) and the average licenses per company (55% growth).

	2015	2016	2017	2018	2019
Multistate Money Transmitters	231	243	245	250	272
Average Licenses per Company	7.4	9.7	10.5	12.9	11.5

Source: NMLS data

The licensing data reflect two trends. First, mergers and acquisitions (M&A) has played a significant role in the industry. As startups grow, they are being bought by larger, established companies. Key M&A activity includes:

Acquired Company	Acquiring Company	Date
Custom House	Western Union	2009
Braintree (Venmo)	PayPal	2013
Xoom	PayPal	2015
Softgate Systems	TIO Networks	2017
TIO Networks	PayPal	2017

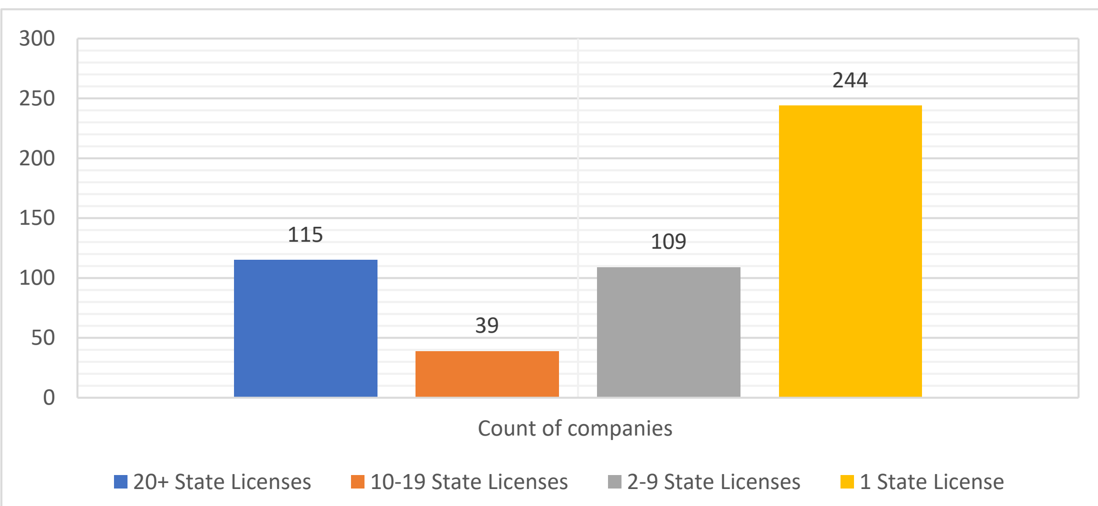
In addition to M&A, many companies ceased operations, changed business plans to activities that do not require licensure, rolled up multiple subsidiaries into one licensee and were "de-risked" [see box]. Altogether from May 31, 2014 to May 31, 2018, a total of 173 companies exited the licensed money transmission space.

As of April 2019, the state licensed money transmission market is dominated by only a handful of companies. In 2018, five companies moved 60% of the funds transferred or stored by all MSBs. Three of these companies are licensed in every state, one is licensed in 49 states, and the last is a crypto company licensed in 42 states. These companies are not alone – 69 companies are licensed in 42 or more states. Accordingly, while states have exclusive jurisdiction within their borders, the money transmission business is national – and often global – in nature.

Despite the market dominance of these companies, the majority of companies are licensed in only one state (see chart below). These small licensees take on many different roles in state economies, including payment services in local stores, startups and remittance providers for local ex-pat populations. Given this high level of competition, it is no surprise that 173 companies ceased licensed operations over a five-year span.

WHAT IS DERISKING?

De-risking refers to financial institutions closing the accounts of clients perceived as high risk for money laundering or terrorist financing abuse, namely MSBs, nonprofit organizations, correspondent banks and foreign embassies. (*Understanding Bank Derisking and Its Effects on Financial Inclusion*. Tracey Durner and Liat Shetret Global Center on Cooperative Security, 2015) MSBs, including money transmitters important to the global flow of remittances, are losing access to traditional banking services. State regulators recognized this phenomenon through the examination of MSBs. Similarly, the Financial Crimes Enforcement Network (FinCEN) has acknowledged that banks have indiscriminately terminated the accounts of MSBs, or refuse to open accounts for any MSBs, thereby eliminating them as a category of customers. (CSBS, 2016)



Source: NMLS Call Report Data

MSB Examination

Given the importance and local impact of money transmitters, the states perform regular exams at money transmitters, big and small. While state agencies have various frequency cycles for conducting examinations, most licensed money transmitters are examined annually by either multistate teams or individual states to ensure licensees operate in a safe and sound manner and in adherence to state and federal laws and regulations.[10] Between exams, state regulators monitor their licensees on an ongoing basis by reviewing the information submitted pursuant to reporting requirements. Licensees have periodic reporting requirements covering financial statements, permissible investments[11] adequacy, branch and agent listings and transmission volume activity. Consumer complaints provide another input into the supervisory process.

During an examination, state examiners review a money transmitter's operations, financial condition, management, compliance function and compliance with the Bank Secrecy Act and the institution's anti-money laundering program. All these areas of review provide state agencies with data and other information to assess if a licensee is complying with applicable laws and conducting business in a safe and sound manner. If a licensee is found operating in an unsafe manner or out of compliance with state and federal requirements, the licensee may face state enforcement actions.

BSA/AML compliance is a substantial portion of money transmitter exams. During an exam, state examiners review the following for BSA/AML compliance:

- Registration with FinCEN
- Agent Monitoring
- BSA/AML Risk Assessment
- AML Programs
- Procedures for mitigating money laundering and terrorist financing from foreign agent or counterparty relationships
- Currency Transaction Reporting
- International Transportation of Currency of Monetary Instruments Reporting
- Foreign Bank and Financial Accounts Reporting
- Suspicious Activity Reporting
- Purchase and Sale of Monetary Instruments Record Keeping
- Funds Transfers Record Keeping
- Voluntary Information Sharing
- Internal Controls
- Independent Review of BSA/AML Program
- Information Systems Adequacy
- Training
- Office of Foreign Assets Control Requirements
- Personal Information Safeguards

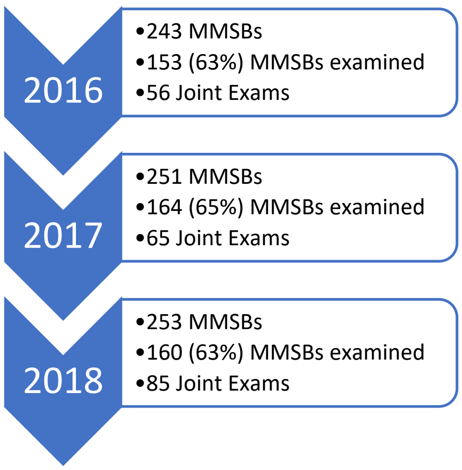
MSB supervision is not without its challenges. Given the multistate nature of many businesses, jurisdictional requirements often result in more exams than is typical for banks and nonbanks alike. Reducing unnecessary duplication and improving multistate exam coordination is a priority of CSBS and its members, which is reflected in the decreased repetitive exams in 2018.

[10] For many states, the supervision of check cashers falls within their MSB division. For others, they may be examined as a separate supervisory discipline or in concert with payday lending reviews. Examinations of check casher organizations typically take one day and are much smaller in scale when compared to a money transmitter exam.

[11] Permissible investments are high-quality assets that must be reserved against money transmission liabilities.

Multistate Supervision

Many state MSB licensees hold licenses in more than one state. Consequently, state agencies have proactively built a foundation for multistate coordination and examinations. The Money Transmitter Regulators Association (MTRA) formed the foundation for multistate MSB efforts by executing the Money Transmitter Regulators Cooperative Agreement (MTRA Agreement) in 2009 and the MTRA Examination Protocol (MTRA Protocol) in 2010. These documents established the initial framework for states to coordinate MSB examinations and share information.



The MTRA Agreement started the states on the path to coordinated regulatory oversight by promoting concurrent and joint examinations among states. The MTRA Protocol provided a process for examinations, including multistate examination schedules, work programs and reports designed to increase effectiveness and reduce regulatory burden. Since the MTRA Agreement and Protocol were implemented, state agencies have conducted over 400 multistate MSB examinations. Through coordination, regulatory oversight is applied in a uniform manner, a benefit that has been publicly noted by industry.

To foster consistency, coordination and communication, the states have collaborated on the enhanced CSBS/MTRA Nationwide Cooperative Agreement for MSB Supervision and the Protocol for Performing Multistate Examinations. The CSBS/MTRA Agreement and Protocol supplement an effective and efficient regulatory framework for licensees by establishing the Multistate MSB Examination Taskforce (MMET) to oversee joint examinations. The MMET is comprised of 10 state members representing 49 signatory states and territories under the agreement. The MMET advances a supervisory program tailored to multistate licensees that fosters consistency and coordination among state agencies.

In 2018, there were 292 examinations of multistate money transmitters, 85 of which were joint exams consisting of examiners from multiple states. Participation on joint exams was widespread, with 29 states joining multistate exams. Sixteen states acted as lead states, where the lead state provides the Examiner in Charge for the exam.

To avoid duplication, many states accept the exams of other states. Where jurisdiction is shared, the states coordinate to avoid regulatory burden and more effectively deploy state resources.

Coordinating with Federal Agencies

MSB supervision is shared with two federal regulators: The Consumer Financial Protection Bureau (CFPB) and FinCEN, which delegates supervision of MSBs to the Internal Revenue Service (IRS).[12] Each set of regulators have a different supervisory mission, with the primary focus as follows:

- State Regulators: Safety and soundness, BSA/AML compliance, consumer protection
- CFPB: Consumer protection
- IRS: BSA/AML compliance

292 exams conducted, covering 63% of all licensed MSBs

85 Joint Multistate Examinations, including one in coordination with the CFPB

Over 95% of companies licensed in 40 or more states examined

68 exams accepted by other states

Under the 2011 CFPB-State Information Sharing Memorandum of Understanding and the 2013 CFPB-State Supervisory Coordination Framework, the states coordinate supervision of MSBs falling under both state and CFPB jurisdiction.[13] The bulk of coordination takes place through the sharing of information and reports of examination. However, under the Framework, the states and CFPB conduct a modest number of coordinated examinations each year, meaning that schedules are aligned, examination planning and information is shared and the multistate examination team and CFPB examiners are present at the company's location simultaneously.

Coordination between the IRS and the state system is less formed than CFPB/state coordination, however, the states actively work with FinCEN to better supervise the industry and resolve shared policy interests.

MSB Enforcement

State enforcement actions vary depending on the entity, substantiated behavior and type and nature of violation. Importantly, enforcement is subject to appeal to an administrative hearing, ensuring licensees are afforded due process. For less serious findings warranting redress, the regulator and the regulated entity might agree to a letter of understanding or consent order, acknowledging the violation and setting forth a corrective plan. For more serious violations, temporary or permanent cease and desist orders will be issued, potentially limiting or even halting an entity's ability to operate. In more egregious circumstances, civil money penalties will be imposed in addition to any consumer restitution. Additionally, an entity's license could be revoked, and the regulator's findings may necessitate referral to state and/or federal law enforcement. For more on enforcement see *Chapter Two – Overview of State Nonbank Supervision*.

[12] Apart from check cashing, where the states are currently the only supervisory presence.
[13] CFPB examination jurisdiction applies to money remitters conducting $1 million of foreign remittances per year.

Forward Looking Supervision

In 2019, the states began experimenting with alternative supervisory approaches focused on effectiveness, efficiency and the reduction of duplicative regulatory burden.

Multistate MSB Licensing Agreement (MMLA)

The MMLA is a concept introduced by the Washington Department of Financial Institutions whereby money transmitters seeking licenses in multiple states can begin the process by submitting a single application to a participating MMLA state. That state is responsible for the initial phase of license approval and the other participating states agree to accept the first state's review.

Twenty-six states currently participate in the MMLA. Fifteen companies have been issued approximately 150 licensees through this expedited process as of September 2019.

One Company One Exam

One Company One Exam was a test pilot to determine whether a single multistate examination would suffice for all other states. While the pilot is still ongoing, as of October, several states had indicated acceptance of the multistate exam and no state had expressed the intent to perform a second examination of the targeted company.

The One Company One Exam pilot was an important step towards reducing regulatory burden and improving efficient use of limited state resources through reliance. Early indications are that this approach can work, opening the opportunity for states to begin developing a more integrated examination scheduling process.

Check Cashing Supervision

Check cashing enterprises that meet the definition of an MSB are required to register with the Financial Crimes Enforcement Network (FinCEN) and are subject to applicable state regulation. Many, but not all states, license check cashers through NMLS, and a subset of states on NMLS require check cashers to file the MSB Call Report.

Due to incomplete capture of licensing numbers through NMLS, an accurate count of the number of licensed check cashers is difficult. According to Sept. 10, 2019, FinCEN registration counts, 19,446 check cashers are federally registered, with 18,953 of those companies operating in only one state. However, according to FiSCA, these registration numbers may include businesses like grocery stores or bodegas that cash checks, which may be treated differently by states.

For many states, the supervision of check cashers falls within their MSB division. However, examinations of check cashers generally take one day and are much smaller in scale when compared to a money transmitter exam.

Conclusion

MSBs have a long and important history in the U.S. consumer financial services market, and the states have provided critical oversight of the industry for more than 100 years. State regulation has not come without its challenges, most critically the growth of nationally operating fintechs, including virtual currency transmitters. The states have been working to improve both efficiency and effectiveness, which benefits both industry and regulators. Going forward, new approaches to supervision, such as the MMLA and One Company One Exam approach may pave the path for reengineering this area of nonbank supervision. Efforts to improve the supervisory process for MSBs are also being cemented in updated model law language, which the states can use to make coordinated decisions to improve the user, industry and regulatory experience.