

Date of Hearing: April 29, 2013

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Roger Dickinson, Chair

AB 786 (Dickinson) – As Introduced: February 21, 2013

SUBJECT: Money transmissions.

SUMMARY: Makes various changes to the Money Transmission Act (MTA). Specifically, this bill:

- 1) Exempts from the MTA a person that delivers payroll money on behalf of an employer to employees.
- 2) Revises the minimum net worth requirements so that an applicant or licensee must maintain minimum net worth ranging from \$100,000 to \$500,000 depending on the estimated or actual transaction volume, as determined by the commissioner of Department of Business Oversight.
- 3) Provides the commissioner with authority to increase net worth up to \$2,000,000 if the commissioner determines that the higher net worth is necessary to achieve specified purposes.
- 4) Provides that a licensee may use funds held in a custodial capacity as an agent of its customers to fulfill the eligible securities requirement when those eligible securities that are held in a custodial capacity as an agent of the customer.
- 5) Requires the commissioner to make a determination on the use of custodial accounts to fulfill eligible security requirements on a case-by-case basis.
- 6) Enhances enforcement of the MTA by providing the commissioner the authority to bring an action to enjoin a person from violating the MTA. Additionally, allows the commissioner to seek ancillary relief, including, but not limited to, a claim for restitution, disgorgement, or damages on behalf of the persons injured by the act or practice.

EXISTING LAW establishes the MTA which provides for the following:

- 1) Defines “payment instrument” as a check, draft, money order, traveler’s check, or other instrument for the transmission or payment of money or monetary value, whether or not negotiable. The term does not include a credit card voucher, letter of credit, or any instrument that is redeemable by the issuer for goods or services provided by the issuer or its affiliates.
- 2) Defines “receiving money for transmission” or “money received for transmission” as receiving money or monetary value in the United States for transmission within or outside the United States by electronic or other means. The term does not include sale or issuance of payment instruments and stored value.
- 3) Defines “stored value” as monetary value representing a claim against the issuer that is stored on an electronic or digital medium and evidenced by an electronic or digital record,

and that is intended and accepted for use as a means of redemption for money or monetary value or payment for goods or services. The term does not include a credit card voucher, letter of credit, or any stored value that is only redeemable by the issuer for goods or services provided by the issuer or its affiliates, except to the extent required by applicable law to be redeemable in cash for its cash value.

- 4) Requires licensing for domestic money transmittal services.
- 5) Provides for regulation of non-bank issued stored value cards that may be offered by licensees.
- 6) Prohibits a person from engaging in the business of money transmission in California or advertising, soliciting, or holding itself out as providing money transmission unless licensed.
- 7) Requires specified information to be included in an application for a license which shall be in the form proscribed by the commissioner of DFI.
- 8) Authorizes the commissioner to conduct an examination of an applicant, at the applicant's expense, and would require the commissioner to approve an application for a license if the commissioner makes specified findings, including that the applicant has adequate net worth and is competent to engage in the business of receiving money for transmission. In order to meet the net worth requirements a licensee that sells or issues payment instruments or stored value must maintain securities on deposit on a surety bond of no less than \$500,000 or 50 percent of the average daily balance of outstanding payment instruments and stored value in CA. A licensee engaged in money transmission must either maintain securities or a surety bond not less than \$250,000 and no more than \$2,000,000.
- 9) Requires licensees to file audit reports with the commissioner within 90 days after the end of each fiscal year.
- 10) Imposes various fees and would require the commissioner to levy assessments on licensees for the purposes of administering these provisions regulating money transmission including:
  - a) A \$5,000 application fee;
  - b) An annual license fee of \$2,500;
  - c) An annual branch office fee of \$125 per branch office;
  - d) An annual \$25 fee for each branch employee; and,
  - e) For licensees that sell or issue payment instruments, an annual assessment based on the volume and aggregate face amounts of payment instruments and stored value issued or sold in California.
- 11) A licensee must maintain specified eligible securities including and/or a surety bond and maintain \$500,000 in net-worth.

- 12) Requires a licensee to provide specified notices and disclosures to customers, including a notice relative to a customer's right to a refund, disclosures relating to rates of exchange, a notice indicating that payment instruments are not insured, and a notice providing information on making complaints to the commissioner against a licensee.
- 13) Requires licensees to maintain financial records for a 3-year period.
- 14) Mandates each licensee to file with the commissioner a certified copy of every receipt form used by it or by its agent for receiving money for transmission prior to its first use.
- 15) Authorizes the commissioner to suspend or revoke a license if the commissioner finds that a licensee or agent of a licensee has, among other things, violated the provisions of the act or engaged in fraud or unsound practices and would authorize the commissioner to assess specified civil penalties against a person that violates these provisions.
- 16) Makes it a crime for a person to engage in the business of money transmission without a license or for a person to intentionally make a false statement, misrepresentation, or false certification in a record filed or required to be maintained under these provisions.
- 17) Exempts from licensing,
  - a) The United States or a department, agency, or instrumentality thereof, including any federal reserve bank and any federal home loan bank.
  - b) Money transmission by the United States Postal Service or by a contractor on behalf of the United States Postal Service.
  - c) A state, county, city, or any other governmental agency or governmental subdivision of a state.
  - d) A commercial bank or industrial bank, the deposits of which are insured by the Federal Deposit Insurance Corporation or its successor, or any foreign (other nation) bank.
  - e) Electronic funds transfer of governmental benefits for a federal, state, county, or local governmental agency.
  - f) A board of trade designated as a contract market under the federal Commodity Exchange Act (7 U.S.C. Secs. 1-25, incl.) or a person that, in the ordinary course of business, provides clearance and settlement services for a board of trade to the extent of its operation as or for such a board.
  - g) A person that provides clearance or settlement services pursuant to a registration as a clearing agency or an exemption from registration granted under the federal securities laws to the extent of its operation as such a provider.
  - h) An operator of a payment system to the extent that it provides processing, clearing, or settlement services, between or among persons excluded by this section, in connection with wire transfers, credit card transactions, debit card transactions, stored value

transactions, automated clearing house transfers, or similar funds transfers, to the extent of its operation as such a provider.

- i) A person registered as a securities broker-dealer under federal or state securities laws to the extent of its operation as a broker-dealer.

18) If the commissioner finds all of the following with respect to an application for a license, the commissioner shall approve the application:

- a) The applicant has adequate tangible shareholders' equity, as specified in Section 2040 of the Financial code to engage in the business of money transmission and the financial condition of the applicant is otherwise such that it will be safe and sound for the applicant to engage in the business of money transmission.
- b) The applicant, the directors and officers of the applicant, any person that controls the applicant, and the directors and officers of any person that controls the applicant are of good character and sound financial standing.
- c) The applicant is competent to engage in the business of money transmission.
- d) The applicant's plan for engaging in the business of money transmission affords reasonable promise of successful operation.
- e) It is reasonable to believe that the applicant, if licensed, will engage in the business of money transmission and will comply with all applicable provisions of this chapter and of any regulation or order issued under this chapter.

FISCAL EFFECT: Unknown

COMMENTS:

This bill represents efforts to revise and update provisions of the MTA to address emerging technologies that are changing money transmission and to provide clarity for existing and future licensees. On March 11, 2013 the Banking & Finance Committee convened an oversight hearing to review the MTA. Almost one year prior to the convening of the hearing committee staff had been contacted by numerous parties raising concerns about the MTA and potential unintended consequences of its application. In the brief time since the MTA became law, technological innovation in the payments industry has exploded as money transmission has transcended into mobile applications and new point of sale (POS) devices. Whereas, five years ago the bulk of money transmission activity involved international remittances where the customer would go to a brick & mortar location to send money to friends or family in other countries, now mobile phone users can use apps to pay for goods and services where the customers payment method (credit card or bank account) sends money to the third party provider and then that provider sends payment to the provider of goods and services. The definition of "money transmission" doesn't provide the answer to these issues, as it's defined, as the transmission of money from one party to another. This could include a host of various activities, though it is relevant to ask if the original intent of the MTA was to cover any and all instances when money is sent from one party to another via a third party?

Proposed federal regulations.

Federal Regulation E, the Electronic Funds Transfer Act (EFTA) was amended via the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) to include regulation of international remittances and money transfer. Section 1073 of Dodd-Frank expanded the scope of EFTA to include requirements concerning remittance disclosures to consumers. The Consumer Financial Protection Bureau (CFPB) has been tasked with creating rules to implement these changes. Last year, CFPB released draft rules that were to take effect February of 2013. However, CFPB postponed the final rules until later in the year to work out potential compliance issues. A brief description of the new requirements:

- Money transmitters will be required to provide customers with written pre-payment disclosures containing information about the specific transfer, such as the exchange rate, applicable fees and taxes, and the amount to be received by the designated recipient.
- Money transmitters will be required to provide a written receipt when payment is made. The receipt must include the information provided on the pre-payment disclosure, as well as additional information, such as the date of availability, the recipient's contact information, and information regarding the customer's error resolution and cancellation rights. As an alternative, the new money transmitter regulation allows money transmitters to give customers a single written disclosure prior to payment containing all of the information required on the receipt, so long as the money transmitter also provides proof of payment such as a stamp on the earlier document.
- The pre-payment disclosures and receipts must be provided in English and in each of the foreign languages principally used by the money transmitter to advertise, solicit, or market money transfer services at a particular office. If you offer customers the ability to make money transfers using text message or a mobile application, the new money transmitter regulation provides additional guidance on how to provide the required disclosures.
- If, (i) due to the laws of a recipient country or (ii) the method by which transactions are made in the recipient country, a money transmitter cannot determine certain amounts that are required to be disclosed, exceptions permit the money transmitter to disclose an estimate of the amount of currency to be received, rather than the actual amount.
- Money transmitters will be required to provide customers with a 30-minute cancellation period that allows a customer the opportunity to review both the prepayment disclosure and the receipt to ensure that the transfer was sent as the customer intended. If a customer requests, a money transmitter must promptly provide the customer a notice describing the customer's "error resolution" and cancellation rights, using specified language or substantially similar language. Even after the cancellation period has passed, customers will have a right to a refund or other remedy if an error occurs in a transaction.
- In the event a customer timely requests the cancellation of a money transfer, the new money transmitter regulation requires money transmitters to provide customers with a refund, at no additional cost to the customer, the total amount of funds provided by the

customer, including any fees and, to the extent not prohibited by law, taxes imposed in connection with the money transfer, within three business days of receiving the request to cancel the money transfer.

The United States Department of Treasury under the Financial Crimes Enforcement Network (FinCEN) requires registration of money services businesses (MSB). According to FinCEN an MSB includes any person doing business, whether or not on a regular basis or as an organized business concern, in one or more of the following capacities, and that meets a threshold of \$1,000 or more in transactions per day:

- Currency dealer or exchanger.
- Check casher.
- Issuer of traveler's checks, money orders or stored value.
- Seller or redeemer of traveler's checks, money orders or stored value;
- Money transmitter.

FinCEN registration does not apply to a bank or a person regulated or registered with the Securities and Exchange Commission. Entities registered with FinCEN must make electronic filings under the Bank Secrecy Act (BSA). As of July 1, 2012, all such filings must be electronic and made through the BSA E-Filing System. Reports that must be filed through this system include, but are not limited to:

- Currency Transaction Report (FinCEN Form 104)
- Designation of Exempt Person (FinCEN Form 110)
- Suspicious Activity Report (Form TD F 90-22.47)
- Suspicious Activity Report by the Securities and Futures Industries (FinCEN Form 101)
- Suspicious Activity Report by Money Services Business (FinCEN Form 109, formerly 90-22.56)
- Suspicious Activity Report by Casinos and Card Clubs (FinCEN Form 102)
- Currency Transaction Report by Casinos (FinCEN Form 103, formerly 8362)
- Registration of Money Services Business (FinCEN Form 107)
- Report of Foreign Bank and Financial Accounts (Form TD F 90-22.1)

Emerging technologies.

The last five years have witnessed technological changes that have drastically altered the old business model of remittances, as well as, the ways in which consumers pay for goods and services. Whereas, the traditional model involved visiting the location of a money transmitter agent, new technologies have completely changed the way in which customers send and use money.

Now a consumer wishing to send money to another person for goods, services, or simply as a remittance to family or friends, has various online services to choose from, including applications utilizing smart phones. The way in which consumers pay for goods and services has transcended checks and credit cards and is rapidly evolving with electronic payment systems and new innovative payment networks. Large financial institutions are also getting on the bandwagon as several large financial institutions are offering money transfer services using smart phone and web based applications. In the payments space, typical five channels have been available, 1) Cash 2) Check (Paper or Check 21 substitute check) 3) Automated Clearing House (ACH) transaction 4) Credit/debit/stored value and 5) Wire transfers. Emerging technologies have created new payment methods such as web payments, contactless payments, mobile payments, Bitcoin and other virtual currency.

Between December 2011 and January 2012, the Federal Reserve Board conducted a survey of consumers concerning the use of mobile financial services (<http://www.federalreserve.gov/econresdata/mobile-devices/files/mobile-device-report-201203.pdf>). The following are brief findings from their report:

- 1) Mobile phones and mobile Internet access are in widespread use.
  - a) 87 percent of the U.S. population has a mobile phone.
  - b) 44 percent of mobile phones are smartphones (Internet-enabled).
  - c) 84 percent of smartphone users have accessed the Internet on their phone in the past week.
- 2) The ubiquity of mobile phones is changing the way consumers access financial services.
  - a) 21 percent of mobile phone owners have used mobile banking in the past 12 months.
  - b) 11 percent of those not currently using mobile banking think that they will probably use it within the next 12 months.
  - c) The most common use of mobile banking is to check account balances or recent transactions (90 percent of mobile banking users).
  - d) Transferring money between accounts is the second most common use of mobile banking (42 percent of mobile banking users).
- 3) Mobile phones are also changing the way consumers make payments.

- a) 12 percent of mobile phone owners have made a mobile payment in the past 12 months.
  - b) The most common use of mobile payments was to make an online bill payment (47 percent of mobile payment users).
  - c) 21 percent of mobile payment users transferred money directly to another person's bank, credit card, or PayPal account.
- 4) Perceptions of limited usefulness and concerns about security are holding back the adoption of mobile financial services.
- a) The primary reason why mobile phone users had not yet adopted mobile banking was that they felt their banking needs were being met without the use of mobile banking (58 percent).
  - b) Concerns about the security of the technology were the primary reason given for not using mobile payments (42 percent) and the second most common reason given for not using mobile banking (48 percent).
  - c) More than a third of mobile phone users who do not use mobile payments either don't see any benefit from using mobile payments or find it easier to pay with another method.
- 5) The "underbanked" make significant use of mobile financial services.
- a) The underbanked make comparatively heavy use of both mobile banking and mobile payments, with 29 percent having used mobile banking and 17 percent having used mobile payments in the past 12 months.
  - b) 62 percent of the underbanked who use mobile payments have used it to pay bills.
  - c) 10 percent of the completely unbanked reports using mobile banking in the past 12 months, and 12 percent have made a mobile payment.

Mobile payment devices and systems are turning into new and innovative ways for businesses to accept electronic payments.

In addition to the money transmission licensing acts across 48 states, James Freis, Director of FinCEN testified on June 29, 2012, in front of the U.S. House Committee on Financial Services,

*FinCEN's regulations also have made it clear that the acceptance and transmission of currency, funds, or other value that substitutes for currency from one person and the transmission of currency, funds, or other value that substitutes for currency to another person or location, by any means, constitutes money transmission, and that any person wherever located doing business wholly or in substantial part within the United States engaging in money transmission, regardless of any other business lines the person is engaged in – such as the provision of telecommunication services – would likely be a money services business under FinCEN's regulations, and as such must register and*

*comply with all the reporting, recordkeeping, and monitoring requirements applicable to a money transmitter.*

#### Payment networks:

Payment networks are the infrastructure, made up of multiple parties, that provide for the processing of electronic financial transactions, most notably, credit card transactions. A typical credit card transaction has four parties: the customer, the bank that issued the customer's card, the merchant, and the merchant's bank. The merchant typically receives less than the merchant's bank as the transaction is discounted due to the interchange rate (paid to network) and any fees paid to the merchant bank. The largest payment networks are Visa, MasterCard, Discover and American Express. The top issuers of credit cards are American Express, JP Morgan Chase, Bank of America, and Citigroup.

The emergence of alternative payment networks has arisen in large part from the desire of merchants to mitigate the fees and costs associated with the traditional payment networks.

#### Stored Value:

An additional expanding model in the money transmission business is the use of stored value, typically via a pre-paid card, but new technology is growing the use of stored value across new mediums. The MTA regulates the issuance of non-bank stored value, and exempts stored value offered by a bank, or stored value on what is known as a "closed-loop" system. A closed loop system is typically a gift card or some other item representing monetary value that can only be used within the network of a given retailer or merchant. Money transferred via traditional means using an agent, or via computer can often be loaded onto a stored value device and provided to the receiver.

#### Remaining issues.

Committee staff has communicated with numerous parties on outstanding issues related to the MTA.

AB 786 currently provides the initial steps of reform for the MTA by addressing some of the main issues of concern. Following outlines the outstanding issues that are still being discussed by the author, staff and interested parties:

- 1) How do we ensure that the MTA is able to keep up with emerging technologies in the payments industry? When is a payment system not engaged in money transmission as defined under the MTA? The potential solution to this issue is to require the commissioner to draft clarifying regulations.
- 2) Licensing as a money transmitter creates significant compliance costs, specifically in the case of start-ups with mobile application platforms. Internet based applications while creating a faster and easier way to reach consumers, also blurs jurisdictional lines a California companies who are able to reach consumers across every state and countries around the world. This often requires licensing across numerous states. Each state has its own special requirements to be licensed as a money transmitter. Some of these states have requirements that are very similar to the requirements in California. Potentially some relief could be

provided to this issue if whether it is appropriate to create some type of hybrid reciprocal relationship between states that have the same or similar consumer protections in their money transmission statutes.

- 3) Net worth and bonding requirements. Currently, the MTA requires that a licensee maintain a minimum net worth of \$500,000 with a maximum of \$2,000,000. An applicant for a licensee may have to demonstrate a net worth over the minimum amount. As some current and potential future licensees have indicated to staff, the application process is very unclear on what amount of net worth will be required, and how this net worth is calculated. Currently, AB 786 attempts to provide clarity to this issue. Discussions are ongoing regarding additional clarifications on the net worth requirements.
- 4) Payroll service companies have expressed concern that they could be interpreted as money transmitters under the MTA. While some of these companies currently offer, or may offer in the future, lines of business that could require an MTA license, AB 786 is clear that payroll service companies are exempt from licensing under the MTA. Additionally, on March 28<sup>th</sup>, 2013 the commissioner released Commissioner's Opinion-No. 001 which provides that for purposes of the MTA's definition of "receiving money for transmission" payroll processing companies, among other types of entities, that are not required to be licensed provided that the companies or other person only receive instructions, orders, or directions to transmit money or monetary value and do not actually take possession or hold the money for transmission.
- 5) The MTA requires that a consumer receive a receipt for their transaction that includes a "right to refund" disclosure statement. In the case of licensees that offer goods and services and are subject to federal regulations concerning credit card transactions, it may not be necessary to require this specific receipt in a transaction for goods and services.
- 6) In relation to the provision of goods and services some of these transactions may appear to be money transmission, but in fact, may be typical retail transactions. In order to provide clarity to this issue it may be necessary to provide clarity on the relationship of agents and payees in the payments ecosystem.

The aforementioned issues are part of ongoing discussions between interested parties.

REGISTERED SUPPORT / OPPOSITION:

Support

National Payroll Reporting Consortium (NPRC)

Opposition

None on file.

Analysis Prepared by: Mark Farouk / B. & F. / (916) 319-3081