Regulating Money Transmission in a New Era

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Summary

- **Regulating Money Transmission Activity**
  - Why regulate what is regulated?

- **The Changing Landscape**
  - Taxonomy of the Money Transmission Universe
  - Why are we in a new era?

- **Approaching New Regulatory Challenges**
  - How are regulators addressing new technologies and services, and thinking about how to regulate into the future?
Basis for Regulation

• The question:
  • What do regulators want to achieve, generally speaking?

• At the state level
  • Consumer protection is the core concern
    • Safety and soundness
    • Fraud prevention and protection
  • Crime and terrorism prevention/anti-money laundering

• Federal regulation and oversight
  • Terrorism, money laundering, recordkeeping and reporting compliance, and fraud
  • Safety and soundness is secondary

• Who are the regulators/policymakers?
  • State banking departments
  • FinCEN, IRS, FTC, CFPB, FATF
Regulatory Boundaries

• What makes somebody a money transmitter?
  • Receiving and sending funds on behalf of a consumer?
  • Receiving and sending funds on behalf of a business?
  • Processing payments?
  • Providing services to merchants?
Regulatory Focus

• Consumer protection
  • Safety and soundness concerns

• Exemptions for financial institutions already regulated for safety and soundness (i.e., a bank)
  • But since money laundering concerns still exist, federal oversight (i.e., the Bank Secrecy Act) applies

• What is the public policy underlying state transmitter licensing?
Regulating in Practice

• Why does regulatory consistency matter?
  • Consistent, robust regulation makes compliance easier, and drives down compliance costs.

• Regulation should generally be consistent since regulators have the same goals—particularly safety and soundness—and since transmitters’ business models do not vary by state, especially in the internet age
The Changing Landscape

• Innovation in financial products and services
  • New consumer services provided by non-bank financial institutions
  • Non-bank financial institutions providing services to *merchants* (or consumers) to replace *merchant’s* banking relationships

• New “Taxonomy” of money transmission
  • “Traditional” money transmission services
  • “Non-traditional” providers of “traditional” money transmission services
  • “Non-traditional” services
    • Including alternative payments services
  • Bitcoin
“Traditional” Money Transmission

- Brick-and-mortar
- Agent location model
- Basic consumer to consumer transmissions, international remittances, money orders, other payment instruments, etc.
- Also contemplates consumer to business (bill payment)
- Large number of cash-in, cash-out type of transmissions
- Services provided to consumers, through consumer facing entities
“Non-Traditional” Providers

- Typically provide money transmission services through website, mobile application, or even integrated into an existing standalone service like a text or chat app
- May also offer stored value or “wallet” type of experiences
- “Traditional” money transmission-type products and services, but using new technologies, platforms, etc.
- Online-only (i.e., no agents) model
- Cash-in/cash-out much less common (ACH, debit, or even credit card payments)
- Still consumer facing, but these transmitters often have “customers” and these customers often have accounts
Non-Traditional Services

• Examples:
  • “Payment processing”
  • Online bill payment as “agent of the payee” or otherwise
  • Third-party marketplaces

• These services all really come within the same ambit, and raise fundamental, interrelated questions from a regulatory perspective
“Payment Processing”

- What is “payment processing”?
  - Credit card data processing
  - Merchant payment acceptance
  - Back-end clearing services
  - Biller agency relationships?

- What makes a service payment processing and not money transmission?
  - Service provided on behalf of the merchant, not the customer
  - Data processors—only banks touch money

- Are third-party marketplaces payment processors or money transmitters?

- What about payee agents?
Merchant Payment Processing Basics

• The players:
  • Cardholder
  • Merchant
  • Acquiring bank
  • Data processor
  • Issuing bank

• The transaction:
  • Cardholder swipes card
  • Data goes to the acquiring bank (the bank that provides credit card services to the merchant) and the issuing bank (bank that issued the card account to the cardholder)
  • Acquiring bank reimburses the merchant
  • Issuing bank reimburses the acquiring bank
  • Issuer collects funds from the consumer
  • Data processor moves information between the merchant bank and the issuing bank, but never touches funds
The “New” Payment Processing

• Non-bank entity receives funds on behalf of the merchant
  • Replaces the merchant acquirer (from the perspective of the merchant)
• Variations in payment processing models
  • Online bill payment, including rental payments
  • “Agent of the payee” and “payment processing” considerations
  • Online marketplaces raise similar issues
• What is the impact on the consumer/sender?
• Is there a transaction other than money transmission?
Bitcoin...

- States are taking different approaches
  - Defining money transmission to include “virtual currency” and incorporating bitcoin transmission into the existing money transmission regulatory framework
  - Creating a new regulatory framework specific to bitcoin exchanges
- Thinking about bitcoin exchanges
New Regulatory Challenges

• In light of these new developments, especially payment processing, the shift to online and mobile, and bitcoin:
  • What is money transmission?
  • What requires regulation and what does not?
    • By statute or discretion?
  • How does industry know?
  • How do regulators know?
  • Does regulation risk stifling innovation?
  • Is unregulated activity putting consumers at risk?
  • Are we seeing high-levels of non-compliance?
  • What about “license rental” issues?
Regulatory Reactions to Innovation

- Standard “payee agent” exemptions
  - Explicit exemptions, e.g., Nevada, Nebraska, New York and Ohio
  - Implicit exemptions?
  - Explicit bars on payee agency?

- New exemptions
  - California and Virginia
  - Pending legislation in North Carolina and Pennsylvania
  - Illinois approach

- Pushback on “license rental”
New Services, Old Model

• Some new types of money transmission services fit the traditional model, but work in different ways
  • I.e., online bill payment, rental payments, etc.
  • These services are generally money transmission; simply offering them online does not change the nature of the underlying transaction
New Services, New Model?

- Some new services do not fit the traditional model
  - Are they money transmission?
- FinCEN perspective can be instructive
  - Of course, not focused on safety and soundness, but rather on terrorism and organized crime
  - But insights on where funds flow and where the risk is under various models
- From the state perspective of safety and soundness
  - Are consumer funds held in trust?
  - Are funds being sent on behalf of the consumer, or received on behalf of the merchant?
  - How much separation is there between the ultimate payee and the recipient of the funds?
  - Does the consumer need protection?
Questions?

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