



Navigating state money-transmission laws

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Financial technology companies' entry into the payment, money transmission, consumer and commercial finance, and virtual-currency markets has spotlighted byzantine state money-transmission laws.

State regulators are generally responsible for licensing and supervising the activities of money transmitters that conduct business in their states.¹ Consequently, these companies are subject to different licensing and other regulatory obligations in virtually every state in which they conduct business. For companies that want to offer their products and services to customers throughout the U.S., including fintechs, licensing in particular can be a complicated and costly process.

APPLICATION OF OLD LAWS TO NEW TECHNOLOGIES

One of the most significant challenges that fintechs face is assessing licensing standards that do not contemplate their business activities. Many states enacted money-transmission statutes well before the widespread adoption of the internet, personal computers, and mobile devices. While some states have revised their statutes to address newer delivery channels and provide exemptions for certain types of activities,² relevant laws in a significant number of states have not meaningfully changed in decades and are proving ill-suited for more novel money transfer and payments products.³ Regulators in these states have been forced to apply laws that simply have not kept pace with the rapidly evolving marketplace.

Some state regulators claim a broad reading of their out-of-date laws is necessary to protect consumers and ensure the safety and soundness of the financial marketplace. In doing so, they have arguably expanded the scope of business activities subject to money-transmission licensure. This expansion is most evident in virtual-currency markets.

WHO SHOULD READ THIS?

Executives, general counsel, and chief compliance officers of companies engaged in the sale or issuance of payment instruments or the transmission of money.

WHY READ THIS?

State regulators have become increasingly active in bringing enforcement actions based on unlicensed money transmissions.

Fintechs should understand the challenges associated with identifying, as well as applying for, necessary money-transmission licenses.

1. Under federal law, money-services businesses must register with the Financial Crimes Enforcement Network (FinCEN), a bureau of the Department of the Treasury, and renew their registration every two years. See *generally* 31 U.S.C. § 5330; 31 C.F.R. § 1022.380.
2. See e.g., Ala. Code §§ 8-7A-1 et seq.; Ga. Code Ann. §§ 7-1-680 et seq.; N.H. Rev. Stat. Ann. §§ 399-G:1 et seq.; N.C. Gen. Stat. §§ 53-208.41 et seq.
3. In 2000, the National Conference of Commissioners on Uniform State Laws promulgated the Uniform Money Services Act (UMSA) to provide states with a uniform framework for regulating money transmission, check cashing, and currency exchange. To date, less than one-third of states have enacted the UMSA.

Federal law makes relatively clear that a person engaged in the business of accepting and transmitting or buying and selling convertible virtual currency must register with FinCEN as a money services business (MSB).⁴ State licensing obligations, however, are less straightforward. While a limited number of states, including New York,⁵ Texas,⁶ and Washington,⁷ clarified through interpretive guidance or statutory amendments the applicability of state money-transmission laws to virtual-currency activities, many more have not. This is troubling given that the penalties for operating an unlicensed money transmitter can be significant. State regulators commonly issue cease and desist orders to unlicensed entities, and also may impose civil money penalties for each day such entity engages in money-transmitting activities without a license.⁸

Notwithstanding the potential for penalties, countless fintechs engaged in virtual-currency activities have made the strategic decision to commence business in states without obtaining a license. The rationale behind each company's decision varies, but many fintechs have cited the lack of clarity regarding the applicability of the state's money-transmission statute, the upfront costs associated with applying for licenses in numerous states, and a desire to be first to market as justification for the decision.

STATE LICENSING REGIME

Money-transmission laws are rules-based (as opposed to principles-based) and riddled with compliance obligations; they are not uniform and typically lack the flexibility to foster financial innovation in an efficient manner. As a result, while they generally share the stated goal of regulating the transfer of money,

substantive differences in definitions of “money transmission” mean that certain activities may be within the scope of regulation in one state, but outside the scope in another. For fintechs looking to establish a national presence, assessing whether their proposed activities even trigger licensure in various states is often a necessary first step.

Companies will therefore undertake the tedious exercise of examining money-transmission laws in the 49 states that have them to determine if their proposed business requires a license, and whether they may rely on statutory or regulatory exemptions.⁹ This examination, however, does not always yield clear results. For example, while certain payment processing, custodial, and virtual-currency activities do not fall squarely within the scope of a regulation, that may not absolve the company of the need to obtain a license. Rather, it could mean that further clarification from regulators is necessary. While the majority of states have developed a formal process for fintechs to obtain clarification on licensing matters (e.g., requests for interpretive opinions), the process can take several months and may result in significant delays in launching a product.

Once a company determines that it requires a license or decides to apply for a license in an abundance of caution, it must navigate the application process — a process made more complicated, and costly, where multiple state licenses are sought. Between the cost of application fees, renewal fees, net-worth requirements, surety-bond premiums, and other expenses associated with obtaining licenses (e.g., developing internal controls such as anti-money-laundering and cybersecurity programs), it is not uncommon for expenditures

4. See generally FinCEN, *Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies*, FIN-2013-G001 (Mar. 18, 2013), <https://www.fincen.gov/sites/default/files/shared/FIN-2013-G001.pdf>.

5. See generally 23 NYCRR Part 200.

6. Supervisory Memorandum – 1037, Texas Dep't of Banking, *Regulatory Treatment of Virtual Currencies Under the Texas Money Services Act* (Apr. 3, 2014), <https://www.dob.texas.gov/public/uploads/files/consumer-information/sm1037.pdf>.

7. Press Release, Washington State Dep't of Fin. Inst., *Amendments to Washington's Money Transmitter Regulations Bring Clarification for Virtual Currency Companies* (June 14, 2017), <https://dfi.wa.gov/news/press/virtual-currency-regulation>.

8. See, e.g., *Order to Cease and Desist*, Bulbul Investments LLC dba CampBX Trading Platform, Georgia Dep't of Banking and Fin. (June 20, 2018), https://dbf.georgia.gov/sites/dbf.georgia.gov/files/related_files/press_release/Bulbul-Investments-dba-CampBX-FinalOrder.pdf.

9. Montana has not enacted a money-transmission law.

RECIPROCITY MAY ONE DAY LEAD TO A SIGNIFICANT REDUCTION IN THE TIME IT TAKES FOR REGULATORS TO REVIEW APPLICATIONS; HOWEVER, GIVEN THAT ONLY A SUBSET OF STATES ARE CURRENTLY PARTY TO THE AGREEMENT, THE BENEFITS ARE CURRENTLY LIMITED

to mount into the mid-six figures — a cost-prohibitive sum for many fintechs.

Applicants must respond to requests for additional information or other inquiries while regulators evaluate the application. Although a number of states have statutory or regulatory requirements specifying the number of days they have to approve or deny an application, the clock only truly begins to run when the regulator deems an application “complete.” It can take months or years for a fintech to obtain all the licenses required to conduct business.

In recognition of the time and costs spent by institutions applying for licenses, a number of states have committed to a multistate agreement, which standardizes key elements of the licensing process for money services businesses, including money transmitters. The agreement is a product of Vision 2020, an initiative of the Conference of State Bank Supervisors that aims to modernize state regulation of nonbanks. Under the agreement, “if one state reviews key elements of state licensing for a money transmitter — IT, cybersecurity, business plan, background check, and compliance with the federal Bank Secrecy Act — then other participating states agree to accept the findings.”¹⁰ Reciprocity may one day lead to a significant reduction in the time it takes for regulators to review applications; however, given that only a subset of states are currently party to the agreement, the benefits are currently limited.¹¹

ALTERNATIVES TO STATE LICENSING

Fintechs seeking to avoid the state money-transmission licensing process have alternatives.

Fintech charter. On July 31, the Office of the Comptroller of the Currency announced that nondepository fintech firms engaged in a core banking function may apply for a special purpose national bank charter. Businesses with this charter may conduct some financial service activities without state licenses, but will be subject to supervision and examination by the OCC.

The OCC has yet to issue a fintech charter and a number of critical questions about it remain unanswered — namely, whether it will issue one to companies engaged exclusively or primarily in money transmission or to companies without a significant track record. State regulators may also mount successful challenges to the charter.

Bank sponsorship. Bank sponsorships are another potential option for fintechs engaged in money transmission. In that model, a sponsoring bank is responsible for handling the movement of money on behalf of the fintech. Typically, fintechs that rely on bank sponsorships must adhere to the bank’s policies and procedures and are subject to examination by the sponsoring bank’s prudential regulator by virtue of acting as the sponsoring bank’s third party. Although the bank sponsorship model

10. Press Release, Conference of State Bank Supervisors, State Regulators Take First Step to Standardize Licensing Practices for Fintech Payments (Feb. 6, 2018), <https://www.csbs.org/state-regulators-take-first-step-standardize-licensing-practices-fintech-payments>.

11. Many state regulators have also recognized the significant burden of having multiple examinations during a single year and have entered into the Money Transmitter Regulators Cooperative Agreement and the Money Transmitter Regulators Association Examination Protocol to facilitate multistate coordination of examinations and information sharing. *Money Transmitter Regulators Cooperative Agreement*, Money Transmitter Regulators Ass’n, <https://www.mtraweb.org/about/cooperative-agreement/> (last visited Sept. 13, 2018); Money Transmitter Regulators Ass’n, *Protocol for Performing Multi-State Examinations* (2012), <https://www.mtraweb.org/wp-content/uploads/2012/10/Protocol-for-Performing-Multi-State-Exams-01-2012.pdf>.

allows fintechs to sidestep the licensing process, given the amount of regulatory scrutiny surrounding third-party oversight, it is becoming increasingly difficult to find bank sponsors.

CONCLUSION

Despite efforts by state regulators to streamline the, applying for and obtaining money-transmission licenses in 49 states remains a daunting endeavor. Understanding this landscape will be critical to any successful, long-term participant. 🌐

ABOUT THE AUTHORS



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