

Legislative Analysis



MONEY TRANSMISSION SERVICES

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House Bill 5328 (Substitute H-3)
Sponsor: Rep. Tupac Hunter

House Bill 5324 as introduced
Sponsor: Rep. Bill Huizenga

House Bill 5329 (Substitute H-1)
Sponsor: Rep. David Palsrok
Committee: Banking and Financial Services

First Analysis (3-16-06)

BRIEF SUMMARY: House Bill 5328 would create the "Money Transmission Services Act" and repeal the current Sales of Checks Act. House Bill 5329 would amend the Code of Criminal Procedures to include the sentencing guidelines felony offenses proposed by House Bill 5328. House Bill 5324 would amend the Consumer Financial Services Act to make it consistent with the new Money Transmission Services Act.

FISCAL IMPACT: This legislation will require the hiring of approximately 4.0 full time equivalent employees, as well as operating costs and software modifications to provide for new license types. The Department estimates the total annual cost for the first year of operation as \$270,000 to \$391,000. This legislation would allow the Office of Financial and Insurance Services to charge regulatory fees sufficient to defray this cost. The Department tentatively recommends a regulatory fee based on a fractional percentage of funds transmitted, but the fee structure has not yet been determined. When sufficient program history exists, the regulatory fees should exactly offset the added regulatory costs, resulting in a net fiscal impact of zero to the State of Michigan.

The bills' fiscal impact on state and local justice systems would depend on how they affected prosecutorial charging practices, numbers of felony convictions, and sentences imposed. The state could incur costs of prison incarceration, which currently averages about \$30,000 per prisoner per year, or felony probation, which currently averages about \$2,000 per supervised offender per year. Counties could incur costs of incarceration in the county jail; those costs vary from county to county. Because the current Sale of Checks act provides for misdemeanor penalties for various violations, local costs could be mitigated by avoidance of costs associated with misdemeanor sanctions, which are a local responsibility. Any penal fines collected could benefit local libraries, which are the constitutionally-designated recipients of such revenues.

THE APPARENT PROBLEM:

According to the Office of Financial and Insurance Services (OFIS), entities involved in the business of electronic or wire transmission of money are currently unregulated in

Michigan. The paper transmission of money is regulated under the Sale of Checks Act, (Public Act 136 of 1969), but the act does not adequately address electronic transmission services.

OFIS says that existing law leaves Michigan vulnerable to those supporting terrorists and terrorism. Legislation has been introduced to address the inadequacy of current law by "completing the regulatory circle envisioned with the passage of the USA Patriot Act." According to state regulators, the USA Patriot Act provides that violation of a state money transmitter law is also violation of the federal act and would subject the person to additional prosecution in federal court. A new state law would help combat money laundering. An OFIS analysis says:

Money laundering is defined as the process by which one conceals the existence, illegal source, or illegal application of income, and then disguises the income to make it appear legitimate. Money laundering typically involves three steps that can occur simultaneously: first, placement of unlawful cash into traditional financial institutions via deposits or other means; second, the separation of the cash from the criminal activity by using several intermediate complex financial transactions, such as converting cash into traveler's checks, money orders, letters of credit, stocks, bonds, purchasing valuable art objects, or wire transfers; and finally the integration of those funds back to the criminal by using an apparently legitimate transaction that disguises the source of the illicit proceeds, such as sham loans or false import/ export invoices.

THE CONTENT OF THE BILLS:

House Bill 5328 would create the "Money Transmission Services Act" and repeal the current Sales of Checks Act.

House Bill 5329 would amend the Code of Criminal Procedures to include the sentencing guidelines felony offenses proposed by House Bill 5328. Intentionally making a false statement, misrepresentation, or certification in a record or document and criminal fraud in the conduct of a money transmission services business, would both be Class E felonies against the public trust, with a statutory maximum sentence of five years' imprisonment.

House Bill 5324 would amend the Consumer Financial Services Act to make it consistent with the new Money Transmission Services Act. House Bill 5324 and 5329 are tie-barred to House Bill 5328, meaning neither bill would take effect unless House Bill 5328 were also enacted.

The new act to be created by House Bill 5328 would do all of the following:

- Prohibit a person from providing "money transmission services" without a license issued under the proposed act, except as otherwise provided.
- Specify requirements for applying for a money transmission services license.

- Require the Commissioner of the Office of Financial and Insurance Services (OFIS) to establish a fee schedule for applicants and licensees.
- Authorize the commissioner to examine and investigate a licensee or any of its "authorized delegates".
- Specify various filing, notice, reporting, and record-keeping requirements of a licensee.
- Require a licensee to maintain a certain amount of permissible investments.
- Regulate a licensee's authorized delegates. ("Authorized delegate" would mean a person whom a license designates to provide money transmission services in this state on behalf of the licensee.)
- Provide for various criminal, civil, and administrative sanctions against a licensee.
- Provide for the confidentiality of information obtained by OFIS and its employees.
- Authorize the commissioner to promulgate rules to implement and enforce the proposed act.
- Repeal the Sale of Checks Act (MCL 487.901-487.916).

Under House Bill 5328, "money transmission services" would mean selling or issuing payment instruments or stored value devices or receiving money or monetary value for transmission. The term would not include solely providing delivery, online, or telecommunications services or network access

A more detailed description of House Bill 5328 follows:

Exemptions:

The proposed act would not apply to any of the following:

- *The United States or a U.S. department, agency, or instrumentality.
- *Money transmission services provided by the U.S. Postal Services or by a contractor on behalf of the postal service.
- *A state, county, city, or other governmental subdivision of a state.
- *A depository financial institution, bank holding company, office of an international banking corporation, or branch of a foreign bank; a bank service company organized under the Federal Bank Service Company Act; or a corporation organized under the Federal Edge Act.
- *Electronic funds transfer of governmental benefits for a governmental agency by a contractor on behalf of the U.S. or a state or a governmental subdivision.

*A board of trade designated as a contract market under the Federal Commodity Exchange Act, or a person who provides clearance and settlement services for a board of trade.

*A registered futures commission merchant under the Federal commodities laws.

*A person who provides clearance or settlement services under a registration as a clearing agency or an exemption from registration granted under the Federal securities laws.

*An operator of a payment system, to the extent that it provides processing, clearing, or settlement services in connection with wire transfers, credit card transactions, debit card transactions, stored value transactions, automated clearinghouse transfers, or similar funds transfers.

*A person registered as a securities broker-dealer under federal or state securities laws.

Licensing Requirements; Application

With some exceptions, a person could not provide money transmission services in Michigan after December 31, 2006 with a license issued under the new act. A person licensed under the Sale of Checks Act on or before the effective date of the new act could provide money transmission services under that license until December 31, 2006.

A person applying for a license would have to use a form and a medium prescribed by the commissioner of OFIS. The application would have to include the applicant's legal name and residential and business addresses as well as any assumed or trade name used in conducting business, and all of the following:

*A list of any criminal convictions and any material litigation involving the applicant in the 10 years before the application.

*A description of any money transmission services previously provided and the services the applicant intended to provide in Michigan.

*A list of the applicant's proposed authorized delegates and the locations where the applicant and the delegates proposed to provide money transmission services.

*A list of all other states in which the applicant was licensed to provide money transmission services and any disciplinary action taken against the applicant in any other state.

*Information about any bankruptcy or receivership proceedings affecting the applicant.

*The name and address of any depository institution through which the applicant's payment instrument would be paid.

*A description of the source of money and credit the applicant would use to provide money transmission services.

*Any other information the commissioner reasonably required

If the applicant were not a natural person (an individual), the applicant also would have to provide information regarding its incorporation or formation, and its structure or organization; its name, assumed or trade names, and business addresses; information about each of the applicant's "control persons"; financial information about the applicant;

the name and address of any registered agent of the applicant in Michigan; and any other information the commissioner reasonably required. ("Control person" would mean a director, manager, or executive officer of a licensee or an individual who had the authority to participate in the direction, directly or indirectly through one or more other individuals, of the management or policies of a licensee.)

An application would have to include a surety bond issued by a bonding company or insurance company authorized to do business in Michigan. The surety bond would have to be in a principal amount of at least \$500,000 and no more than \$1.5 million and could not expire before the money transmission services license expired. The commissioner would determine the amount of the bond based on the number locations and authorized delegates of the applicant in this state. The surety bond would have to be payable to the commissioner for the benefit of Michigan residents who were creditors or claimants of the applicant and its authorized delegates through purchase of a payment instrument from the applicant or a delegate. The bond would have to secure the faithful performance of the obligations of the applicant and its authorized delegates with respect to money received in connection with the money transmission services business

The commissioner would have to investigate the financial condition and responsibility, financial and business experience, character, and general fitness of the applicant and may conduct a similar investigation of each shareholder and control person.

The commissioner would have to approve or deny an application within 120 days after the date he or she determined the application was complete. If the commissioner did not act within 120 days, he or she would have to issue the license, although the commissioner could extend that time period for good cause. An applicant denied a license could appeal within 30 days of the notice of denial and request a hearing on the denial.

Fees and Expenses

The commissioner annually would have to establish a schedule of fees to be paid by applicants and licensees during the next calendar year. A license would expire on December 31 each year unless earlier suspended, surrendered, or revoked. A licensee could renew a license by filing a renewal application in the form and medium prescribed by the commissioner and paying a renewal fee by December 1.

In addition to fees established by the commissioner, a licensee would have to pay the actual travel, lodging, and meal expenses incurred by agency personnel who traveled outside of Michigan to examine the licensee's records and investigate the licensee. An agency employee who incurs expenses under the act would be required to comply with applicable provisions of the standardized travel regulations issued by the department of management and budget and civil service commission.

Examination and Investigation

The commissioner could conduct an examination or investigation of a licensee or any of its authorized delegates and also could conduct an on-site examination or investigation of records, including a joint examination or investigation conducted with other departments

or agencies of this state, another state, or the federal government. Instead of conducting his or her own examination or investigation, the commissioner could accept one done by a department or agency of this state, another state, or the federal government or a report prepared by a certified public accountant.

Confidentiality

The bill would require the commissioner, each former commissioner, and each current and former deputy, agent, and employee of OFIS to keep secret all facts and information obtained in the course of their duties, unless the person was required by law to report on, take official action concerning, or testify in any proceedings regarding a licensee or a licensee's activities.

This requirement would not apply to, or prohibit the provision of information or documents to, any federal, foreign, or out-of-state regulatory agency with jurisdiction over a licensee. The confidentiality requirement also would not apply to any disclosure the commissioner made in the public interest, at his or her discretion.

Licensee Filings, Notices, and Reports

If there were a change in any information provided in a licensee's initial or renewal application, the licensee would have to file that information with the commissioner before the change occurred, unless the commissioner prescribed a different deadline for filing the changed information that is not later than five business days after the change occurs. The commissioner would be required to consider whether it is feasible for the licensee to file the changed information before the change occurred in prescribing a different deadline.

A licensee that submits a renewal application to the commissioner would be required to include, with the application, a current list of names and addresses of each authorized delegate, and location in the state where the licensee or delegate provided money transmission services.

A licensee would have to file a report with the commissioner within three business days after the licensee had reason to know of the filing of a bankruptcy petition by or against the licensee under the Bankruptcy Code; the filing of a petition by or against the licensee for receivership or any other judicial or administrative proceeding for dissolution, reorganization, or the making of a general assignment for the benefit of creditors; the commencement of a proceeding to revoke or suspend the licensee's license in Michigan or another state or country; or a charge or conviction of the licensee or an executive officer, manager, director, control person, or authorized delegate for a felony.

If there were a proposed change of control of a licensee, the licensee would have to give the commissioner at least 30 days' written notice before the proposed change; request approval of the proposed change; and pay a nonrefundable fee with the notice, in an amount prescribed by the commissioner.

If a licensee or authorized delegate filed a suspicious activity report with a federal agency, the licensee or delegate would have to file a copy of that report with the Department of State Police within 24 hours.

Licensee Investments

A licensee would have to maintain at all times permissible investments with a market value computed in accordance with generally accepted accounting principles of not less than the aggregate amount of all of its outstanding payment instruments issued or sold and money transmitted by the licensee or its authorized delegates. The commissioner could limit the extent to which a type of investment within a class of permissible investments was considered a permissible investment, except for money and certificates of deposit issued by a depository financial institution. The commissioner could allow other types of investments that he or she determined had a safety substantially equivalent to other permissible investments.

Except as otherwise limited by the commissioner, each of the following would be a permissible investment:

- *Cash, a certificate of deposit, or a senior debt obligation of a federally insured depository financial institution.

- *A banker's acceptance or bill of exchange that was eligible for purchase upon endorsement by a member bank of the Federal Reserve system and was eligible for purchase by a Federal Reserve bank.

- *An investment bearing a rating of one of the three highest grades as defined by a nationally recognized organization that rates securities.

- *An investment security that was an obligation of the U.S. or a Federal department, agency, or instrumentality; an investment in an obligation that was guaranteed fully as to principal and interest by the U.S.; or an investment in an obligation of a state or a governmental subdivision, agency, or instrumentality of a state.

- *A receivable that was payable to a licensee from its authorized delegate, if the aggregate amount of receivables did not exceed 20 percent of the total permissible investments and the licensee did not hold at one time receivables in any one person aggregating more than 10 percent of the licensee's total permissible investments.

- *A share or a certificate issued by an open-end management investment company that was registered with the U.S. Securities and Exchange Commission under the Investment Company Act and whose portfolio was restricted by the management company's investment policy to specified investments.

The bill also lists other investments that would be permissible under specified conditions. The aggregate of those investments could not exceed 50 percent of an applicant's total permissible investments.

Authorized Delegates

An agreement between a licensee and an authorized delegate would have to be in writing and require the delegate to operate in compliance with the proposed act and other applicable law.

If a license were suspended or revoked, the commissioner would have to notify the licensee and order the licensee to notify its authorized delegates, directing them to cease providing money transmission services on behalf of the licensee. The delegates immediately would have to cease providing those services

All funds received by an authorized delegate from the sale of a payment instrument, less fees, would have to be held in trust for the licensee from the time the funds were received until the time they were remitted to the licensee. If an authorized delegate commingled any of the funds received with any other funds or property it owned or controlled, all commingled funds and other property would have to be impressed with trust for the licensee in an amount equal to the funds due the licensee.

Sanctions and Penalties

License Sanctions. The commissioner could deny, suspend, not renew, or revoke a license, place a licensee in receivership, or order a licensee to revoke the designation of an authorized delegate if any of the following occurred:

- *The licensee violated the proposed act, a rule promulgated under it, an order or declaratory ruling issued under it, or any applicable state or federal law.

- *The licensee did not grant access to its books and records during the course of an examination or investigation by the commissioner.

- *The licensee engaged in fraud, intentional misrepresentation, or gross negligence.

- *An authorized delegate of the licensee was convicted of a violation of a state or federal money laundering statute or violated a rule promulgated or an order or ruling issued under the proposed Act, as a result of the licensee's knowing or willful misconduct.

- *The experience, character, or general fitness of the licensee, authorized delegate, or control person indicated that it was not in the public interest to permit the person to provide money transmission services.

- *The licensee engaged in an unsafe or unsound practice.

- *The licensee failed to maintain the required minimum net worth or was insolvent, suspended payment of its obligations, or made a general assignment for the benefit of its creditors.

- *The licensee did not remove an authorized delegate after the commissioner ordered it to do so after finding that the delegate had violated the proposed act.

In determining whether a licensee was engaging in an unsafe or unsound practice, the commissioner could consider the size and condition of the licensee's money transmission services business, the magnitude of the loss, the gravity of the violation, the previous conduct of the person involved, and other factors the commissioner considered relevant

After conducting an investigation or examination, the commissioner could issue an order summarily suspending a license, based on an affidavit stating that an imminent threat of financial loss or to the public welfare existed.

Other Administrative Sanctions. If the commissioner believed a person had engaged in fraud or had been convicted of a criminal violation involving money laundering, he or she could serve upon that person a written notice of intention to prohibit the person from being employed by, an agent of, or a control person of a licensee.

Criminal Violations. Intentionally making a false statement, misrepresentation, or false certification in any record or document filed or required to be maintained under the proposed act, or intentionally making a false entry or omitting a material entry in a record, would be a felony punishable by up to five years' imprisonment and/or a maximum fine of \$100,000.

Engaging in criminal fraud in the conduct of a money transmission services business also would be a felony punishable by up to five years' imprisonment and/or a maximum fine of \$100,000.

Knowingly engaging in an activity for which a license would be required under the proposed act, when not licensed under the act, would be a felony punishable by up to five years imprisonment and/or a maximum fine of \$100,000, or both.

Cease and Desist Order. The commissioner could issue and serve on a licensee a cease and desist order if he or she believed the licensee was engaging in, had engaged in, or was about to engage in a practice that posed a threat of financial loss or threat to the public welfare or was violating, had violated, or was about to violate a law, rule, or order.

Civil Penalties. The commissioner could assess a civil fine against a person who violated the proposed act, a rule promulgated or an order or ruling issued by the commissioner under it, or any applicable state or federal law. The fine could be up to \$10,000 per day for each day the violation continued, plus the state's costs and expenses for the investigation and prosecution of the matter, including reasonable attorney fees.

ARGUMENTS:

For:

The Office of Financial and Insurance Services has offered the following argument in support of the bill, which was introduced at its request.

Since the market for financial services has become increasingly diverse, complex, and competitive, consumers now face an ever-expanding array of businesses offering money and electronic transfers. Many entities offering these services have not been subject to the same level of regulatory or administrative oversight as state and federal depository financial institutions. The bill would provide a strong uniform law addressing safety and soundness of the entities offering these financial services to customers who do not maintain a formal on-going relationship with a depository financial institution (the "unbanked").

The bill would create a strong licensing mechanism to deter businesses engaging in money laundering and illegal activity from conducting business in this state. It would also strengthen enforcement and supervisory powers to permit OFIS and local, state, and federal law enforcement agencies to take appropriate action if money laundering and other related violations of law were suspected. For entities that engage in money transmission lawfully, the bill would provide a cost-effective means of complying with the law and a clear framework for operations.

Further, the bill provides for strong criminal and civil penalties for violating the act and it provides the OFIS Commissioner a wide range of enforcement tools.

POSITIONS:

Office of Financial and Insurance Services supports the bills, which were introduced at its request. (3-8-06)

The Non-Bank Funds Transmitters Group [consisting of Western Union Financial Services, Inc., MoneyGram International, Travelex Americas, American Express Travel Related Services, RIA Financial Services, Comdata Network, Inc., and Sigue Corporation] supports House Bill 5328. (3-8-06)

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■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.