Easing the Burden on Mobile Payments: Resolving Current Deficiencies in Money Transmitter Regulation

M. MacRae Robinson

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Easing the Burden on Mobile Payments: Resolving Current Deficiencies in Money Transmitter Regulation

I. INTRODUCTION

The use of mobile payment systems is rapidly expanding both at home and abroad, replacing traditional forms of payment. Traditional marketplace interaction between customers and merchants is evolving to a point that largely eliminates physical interactions between the merchant and the customer in a physical store. With currently available payment systems, one can imagine a situation in which a customer, after receiving funds from a friend via email, walks into a store, picks out an item, and leaves the store without swiping a credit card, handing a merchant cash, or writing a check, yet still paying in full, all without having a bank account. This rise of new and innovative mobile payment technologies has created significant federal and state regulatory issues. Moreover, the constant battle between regulation and innovation has had negative consequences on novel payment systems nationwide.

Despite the numerous deficiencies in the regulatory landscape, minimal changes could have a beneficial impact for all parties involved. Part II of this Note defines mobile payments and explores the emerging alternatives to traditional payments systems. Part III discusses the

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3. See Connecting with PayPal Beacon, PayPal.com (last visited Oct. 5, 2013), https://www.paypal.com/webapps/mpp/beacon#learn-more (The PayPal Beacon thumb-drive device works with the merchants point of sale system via Bluetooth network that detects a participating customer when they enter the store. When the customer selects a good or service the only action required of the customer is to confirm that they are using PayPal to pay: there is no signature, card swipe, or confirmation button to push.).
4. See infra Part II.
structure, purposes, and current deficiencies of the federal regulatory framework. Part IV analyzes various state regulatory systems. Part V explores the problems faced by mobile payment businesses. Part VI discusses current attempts at unifying the state regulatory regime, and suggests various amendments to these regulatory systems. Part VII concludes by discussing the likely benefits of nationwide state adoption of a unified regulatory system.

II. OVERVIEW OF EMERGING ALTERNATIVE PAYMENT SYSTEMS

As smart phones become more capable, new and emerging mobile payment technologies are increasingly facilitating transactions, thereby replacing traditional methods of payment such as cash, check, or credit card. This Note discusses the services provided by mobile payment businesses, not mobile banking, necessitating differentiation. Mobile payment businesses are nonbank entities that provide mobile payment services between peers (peer-to-peer or P2P), or between a merchant and customer, by transferring funds from the latter to the former while using a mobile device, either through an Internet website, application-based platform, or through text messages. In contrast, mobile banking is the process of accessing any financial institution accounts, be it checking, savings, credit card, or other bank account.
Mobile banking does not involve the transfer of funds between a merchant and a customer, but may involve the transfer of funds between an individual’s accounts at the same financial institution. Mobile payment businesses such as Google, PayPal, Amazon, and Square offer a variety of mobile payment services. Many of these new mobile payment businesses have contracts with financial institutions to allow the payment system to access the specified account within the financial institution to transfer the amounts necessary for the specific transaction. Furthermore, these mobile payment companies allow customers to use a wide variety of funding mechanisms ranging from traditional channels of funding—such as credit or debit cards, or checking and savings accounts—to novel funding mechanisms such as prepaid cards and mobile carrier billing to facilitate the transaction.

13. See Bd. of Governors of Fed. Reserve Sys., supra note 1, at 9 (Mobile banking is “using a mobile phone to access your bank account, credit card account, or other financial account. Mobile banking can be done either by accessing your bank’s web page through the web browser on your mobile phone, via text messaging, or by using an application downloaded to your mobile phone.”).


15. See Terms of Service - US Buyer, supra note 2; Paypal User Agreement, PAYPAL.COM (Oct. 5, 2013), https://www.paypal.com/webapps/mpp/ua/useragreement-full?locale.x=en-US#3 (PayPal provides mobile payment processing, which can either debit directly from a bank account, a debit card, credit card, or your PayPal account balance. PayPal also has an agreement with MasterCard to have a debit card that works directly with your PayPal account balance. PayPal is a subsidiary of Ebay.); Simple Pay Service, AMAZON.COM, https://payments.amazon.com/sdui/sdui/helpTab/Amazon-Simple-Pay/Creating-Managing-Your-Account/What-Is-Amazon-Simple-Pay (last visited Oct. 5, 2013) (Amazon offers a variety of money payment services business. Depending on the need, they can offer end-to-end service, which provides a virtual market place that connects merchants and prospective buyers, a shopping cart service that will process the payment, and mobile wallet options with NFC capabilities as well); Terms of Service, SQUAREUP.COM (Oct. 5, 2013), https://squareup.com/help/en-us/article/5118-accept-payments-on-smartphones (describing the services offered by Square, from the credit card swiping hardware that is compatible with certain smartphones, to the wallet service).

16. See Terms of Service US Buyer, supra note 2 (describing the terms of service with Bancorp as the issuer of one time MasterCard virtual cards with prepaid value).

Google Wallet is illustrative of a common relationship between the consumer, merchant, mobile payment business, and financial institution. Using the customer’s stored financial institution account information, Google Wallet (the mobile payment business) facilitates the transaction between the merchant and customer either in a physical store through near field communication (NFC) and a mobile application, or through the Internet on a supported marketplace. Specifically, when the customer agrees to purchase a good or service from the merchant, The Bancorp, Inc.—a payments solution provider under contract with Google—issues a onetime, prepaid, virtual MasterCard debit card for the amount of the transaction. Google Wallet debits the single use card and transfers that amount to the merchant and subsequently debits the same amount from the customer’s bank account that is stored in Google Wallet.

Many of these mobile wallets now allow customers to maintain stored balances in their account that can be used to facilitate transactions between consumers and merchants and also between peers. However, these stored balances can pose increased risk for consumers because they usually represent an unsecured claim against the mobile payment company and are not insured by the Federal Deposit Insurance Corporation (FDIC). Moreover, it is commonplace for a mobile wallet provider to pool the stored balances that are deposited at participating banks and invest them in liquid assets.

function they now offer, all other services provided by PayPal require a participant to register a valid bank account, or credit or debit card).

18. See Terms of Service - US Buyer, supra note 2, § 4.2 (describing how to use Google Wallet).


20. See Terms of Service - US Buyer, supra note 2, § 4.5 (explaining how the OneTime prepaid debit card system works).

21. Id.

22. Id. § 6.1 (explaining that any stored value in the Google Wallet is actually deposited at participating banks that agreed to hold Google Wallet balances and agrees to let Google Wallet access and transfer funds from these deposit accounts).

23. Id. (“All Google Wallet Balances will be maintained in a deposit account at a Partner Bank. GPC is not a bank and does not accept deposits or maintain deposit obligations for you. Funds held by GPC or its service providers, including Google Wallet Balances and other funds relating to the P2P service, are not deposit obligations of users and are not insured for the benefit of users by the Federal Deposit Insurance Corporation (‘FDIC’) or any other governmental agency.”).

24. Id. (“[Google] and the Partner Bank do not pay interest to you on Google Wallet Balances or any other funds. You assign to GPC the right to earn interest on funds in the
Google retains all interest earned off the investments. Other companies, including PayPal, Inc., offer a similar mobile wallet service, whereby a consumer’s stored balance represents an unsecured claim, which is pooled with other consumers’ balances and invested for PayPal’s benefit.

Some of the most recent technology almost completely eliminates customer-merchant interaction in physical stores. For example, PayPal Beacon consists of a small thumb-drive device that creates an in-store Bluetooth network that recognizes a participating PayPal customer when the customer enters a participating merchant’s individual network with a mobile phone. When a customer selects a good or service, the customer simply informs the merchant the payment form is PayPal and no other authentication is required. As mobile payment technology continues to evolve, the strain on the regulatory system will continue to increase.

III. FEDERAL REGULATORY SYSTEM

A. Purpose

Since the passage of the Currency and Foreign Transactions Reporting Act of 1970, commonly referred to as the Bank Secrecy Act (BSA), the primary goals of federal regulation of money transmitters is to detect, deter, and prevent money laundering, terrorist financing,

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25. See Terms of Service - US Buyer, supra note 2 (“You assign to GPC the right to earn interest on funds in the deposit account of the Partner Bank, in consideration of your use of the Service.”).

26. See PayPal User Agreement, supra note 15, § 5.1 (“If you do hold a Balance, that Balance represents an unsecured claim against PayPal and is not insured by the FDIC. PayPal will combine your Balance with the Balances of other Users and will invest those funds in liquid investments in accordance with State money transmitter laws. PayPal will own the interest or other earnings on pooled Balances. PayPal will hold pooled Balances separate from its corporate funds and will not use Balances for its operating expenses or for any other corporate purposes.”).

27. See Connecting with PayPal Beacon, supra note 3 (The PayPal Beacon thumb-drive device works with the merchant’s point of sale system by creating a Bluetooth network that detects a participating customer when they enter the store.).

28. Id.

and other related criminal activities. The Secretary of the Treasury, under authority from the BSA, created the Financial Crimes Enforcement Network (FinCEN), which serves as the primary regulator of money transmitters for criminal activity monitoring purposes. Under the BSA, all MSBs must register with FinCEN and are subject to reporting requirements, maintaining detailed financial records, and utilizing anti-money laundering programs. Failure to comply can result in civil and criminal penalties.

Historically, federal money transmitter regulations were focused primarily on the detection and prevention of money laundering and other criminal activities. However, with the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010, the federal government increased the scope of regulation to include consumer protection. Currently, five agencies—the Federal Reserve System, the Consumer Financial Protection Bureau (CFPB), the Office of the Comptroller of the Currency, the National Credit Union Administration, and the Federal Trade Commission (FTC)—all have some responsibility in overseeing the regulation of the mobile payments business. There remains considerable gray area regarding the scope of

30. Id.
32. 31 C.F.R. § 1010.100(ff)(5) ("Money services business. A person wherever located doing business, whether or not on a regular basis or as an organized or licensed business concern, wholly or in substantial part within the United States. . . . This includes but is not limited to maintenance of any agent, agency, branch, or office within the United States.")
34. 31 C.F.R. § 1010.306(a)(1) (2012) (creating the reporting requirements).
35. Id. § 1010.400 (2012) (establishing that records are required to be kept).
36. 31 C.F.R. § 1022.210 (2012) (describing the anti-money laundering programs required of all MSBs).
37. 31 C.F.R. §§ 1010.820 – 850 (2012) (setting forth the criminal and civil penalties faced by illegal or noncomplying MSBs).
40. Id. (establishing that consumer protection legislation was previously unclear in the electronic funds transfer space and that the purpose of the legislation was to define those rights and establish responsibilities for the regulatory agencies); see Creating the Consumer Bureau, CONSUMER FINANCIAL PROTECTION BUREAU, http://www.consumerfinance.gov/the-bureau/creatingthebureau/ (last visited Oct. 28, 2013).
41. CROWE ET AL., supra note 17.
each agency’s authority. However, the CFPB and the FTC currently assume concurrent responsibility of consumer protection.

Pursuant to the Electronic Fund Transfer Act, the CFPB has authority to regulate both consumers and financial institutions engaged in electronic funds transfers to protect against fraudulent and unauthorized transactions. Electronic funds transfers include transfers of funds that are conducted by mobile payment businesses. The chosen funding mechanism directly correlates to the amount of protection afforded to the consumer against fraud or unauthorized transactions. Credit card-based transactions afford the consumer the greatest level of protection, limiting the loss to $50 from a fraudulent or unauthorized transaction, and providing a dispute resolution process. Debit cards and bank accounts are afforded the second highest level of consumer protection, limiting consumers to $50 if the transaction is reported within two business days, $500 if not reported within two business days, and possibly unlimited liability if not reported within 60 business days after the consumer receives a financial statement containing the unauthorized transaction. Additionally, the CFPB acts as a backstop to state level consumer protection by providing that any


44. See Electronic Fund Transfer Act, 15 U.S.C. § 1693 (2012); Creating the Consumer Bureau, supra note 39 (describing the history and purpose of the CFPB).

45. 12 C.F.R. § 1005.3(b) (2013) (“The term ‘electronic fund transfer’ means any transfer of funds that is initiated through an electronic terminal, telephone, computer, or magnetic tape for the purpose of ordering, instructing, or authorizing a financial institution to debit or credit a consumer’s account.”).

46. Id. § 1005.1(b) (describing the purpose and authority of the CFPB in electronic funds transfers).

47. Id. § 1005.3(b) (“The term ‘electronic fund transfer’ means any transfer of funds that is initiated through an electronic terminal, telephone, computer, or magnetic tape for the purpose of ordering, instructing, or authorizing a financial institution to debit or credit a consumer’s account.”).


49. 12 C.F.R. § 1026.12(b) (2013) (limiting the consumer’s loss to $50.00 for unauthorized transactions).

50. See FTC Workshop, supra note 48, at 5-7.
state regulation or agreement between the consumer and financial institution that caps consumer liability for a lesser amount will govern.  

The FTC also has jurisdiction over entities operating in the mobile payments environment and shares responsibility with the CFPB for enforcing regulation on these entities to protect consumers. The FTC protects consumers from fraudulent and deceptive practices through enforcement of the Unfair and Deceptive Trade Act. The FTC has been instrumental in requiring mobile payment processors to create comprehensive privacy programs to protect consumers' private information. Even though the FTC has broad authority to protect consumers in the mobile payments space, FTC regulation does not adequately cover this growing market.

B. Structure

Mobile payment businesses fall under the definition of money transmitters, which are in turn considered a money service business (MSB). MSBs are broadly defined as entities that accept or transmit money. Exemptions are provided under the federal regulatory system to exclude those entities that either do not need to be regulated as money transmitters or are regulated in some other manner. 

51. 12 C.F.R. § 1005.6(b)(6) (explaining that any state law or financial institution agreement with the consumer that caps liability at a lesser amount than the amount given in 12 C.F.R 1005.6(b)(1)-(3) will govern the transaction).
54. See FTC Workshop, supra note 48, at 1.
55. 31 C.F.R. § 1010.100(ff) ("Money transmitter —(i) In general. (A) A person that provides money transmission services. The term 'money transmission services' means the acceptance 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 location or person by any means. 'Any means' includes, but is not limited to, through a financial agency or institution; a Federal Reserve Bank or other facility of one or more Federal Reserve Banks, the Board of Governors of the Federal Reserve System, or both; an electronic funds transfer network; or an informal value transfer system.").
56. Id. § 1010.100(ff) (defining money services business as encompassing money transmitters, which in turn encompasses mobile payment business).
57. Id.
58. See id. §§ 1010.100(ff)(5)(ii)(A)-(F), (8)(i)-(iii) (setting forth the various exceptions to money services businesses).
entities include: (1) payment processors and anyone whose sole function is to facilitate the transfer of funds from the buyer to the seller (or is somehow merely incidental to the exchange of goods or services); and, (2) any entity regulated by the Securities and Exchange Commission (SEC).\footnote{Id. §§ 1010.100(ff)(5)(ii)(A)-(F) (defining specific exemptions for money transmitters which includes: (A) provides infrastructure for money transmitter services, (B) payment processors, (C) intermediaries between BSA regulated entities, (D) physically transports currency such as armored car services, (E) provides prepaid access, (F) accepts and transmits funds only integral to the sale of goods or the provision of services, other than money transmission services, by the person who is accepting and transmitting the funds, (G) US Postal Service, and (H) sells prepaid access); id. at § 1010.100(ff)(8) (defining specific exemptions for money services businesses which includes: (A) a bank or foreign bank, (B) any entity governed by the SEC and CFTC, and (C) anyone who infrequently engages in any of the activities covered under the money services business and does not do so for profit or any sort of economic gain).}

Under current regulation, companies that simply provide a platform to facilitate such transactions (i.e. PayPal, Google, and Amazon) are subject to federal regulation.\footnote{See PayPal Anti-Money Laundering and Counter-Terrorist Financing Statement, PAYPAL.COM, https://www.paypal.com/webapps/mpp/ua/aml-full (explaining that as a financial institution operating at an international level, they employ a rigorous AML program in compliance with federal regulations, indicating that the exceptions to the federal regulation under the CFPB and FTC do not apply) (last updated May 11, 2009); Terms of Service - US Buyer, supra note 2, § 2.2 (“To help the government fight the funding of terrorism and money laundering activities, federal law requires all financial institutions to obtain, verify, and record information that identifies each individual or business that opens an account or requests credit.”).}

The determination of whether an entity is required to register is based on the facts and circumstances of each individual entity.\footnote{31 C.F.R. § 1010.100(ff)(5)(ii) (“Whether a person is a money transmitter as described in this section is a matter of facts and circumstances.”).}

Based on the current regulatory structure, a number of businesses providing mobile payment services are not subject to federal regulation despite their role in interstate commerce.

C. Current Deficiencies in Federal Regulation

One of the biggest concerns facing consumers in the mobile payments sphere is the fact that there currently are no federal regulations, other than the FTC Act, providing consumer protection for fraudulent charges when using prepaid or stored value cards.\footnote{See FTC Workshop, supra note 48, at 5-7.} Pre-paid or stored value cards, which include gift cards, payroll cards, and
general purpose reloadable cards (GPR cards), are being used at an increasing rate, replacing credit or debit cards, especially in “underbanked” communities. In particular, there has been a surge in the use of GPR cards as an alternative to checking accounts and credit cards primarily because they cost less to maintain, have no over drafting fees, and require no credit check. It is estimated that in 2011 alone there were over $27 billion stored on GPR cards in the United States. While the CFPB took steps to solicit ideas on how to address these gaps in GPR card regulation, new regulation has yet to be proposed or enacted to ensure consumer protection. At present, users of gift cards or any stored value card are only guaranteed protections against certain usage fees and notice of expiration dates of the card. More specifically, the protections afforded consumers using all other funding mechanisms under Regulations E and Z do not currently apply to GPR cards. In the place of concrete governmental protections against fraudulent or unauthorized transactions, consumers using prepaid access cards, including GPR cards, are offered unilateral and unenforceable guarantees by the mobile payment business or GPR card manager.


67. See 12 C.F.R. § 1005.20 (2013) (setting forth restrictions on the amount and kind of fees that can be charged to gift cards, providing disclosure requirements, and setting time limits on expiration dates of gift cards and other stored value cards, but not for GPR cards that are not labeled gift cards); id. § 1005.3 (defining the scope of coverage of electronic funds transfers protections); id. § 1005.18 (providing liability protection for payroll cards similar to that of debit cards).


69. See id. (explaining that consumer protection against fraudulent or unauthorized transactions involving prepaid access cards involves unilateral guarantees provided by the mobile payment systems).
Moreover, many of the GPR card issuers claim that consumer deposits are FDIC insured though this is sometimes misleading. While the FDIC will insure each customer’s deposit on the GPR card up to $250,000 through pass-through insurance if held at a FDIC insured bank, the reloading process—usually conducted through retailers—can create a situation where the customer’s funds are not insured until the card issuer deposits those funds into the pooled bank account.

Another area of major concern is the increased use of mobile carrier billing—the funding mechanism whereby mobile payment systems or other third parties agree to bill the consumer’s account with the mobile carrier. Many of the major mobile wallet services allow carrier billing. At present, no federal regulation exists to regulate mobile carrier billing. Instead, consumers must rely on voluntary safeguards provided by the mobile payment businesses or mobile carriers, which are all too often insufficient.

IV. STATE REGULATORY SYSTEMS

A. Purpose

Many state regulatory systems define money transmitters broadly, and then provide exemptions for various entities. State regulation through licenses required for non-exempt entities provides for direct oversight over MSBs and consumer protection. Federal

70. See Pew Charitable Trust, supra note 65, at 5.
71. See id. at 3-4.
72. See FTC Workshop, supra note 48, at 7.
73. See, e.g., Terms of Service- US Buyer, supra note 2, §1.
74. See FTC Workshop, supra note 48, at 7-11 (noting that the CFPB is considering expanding the regulatory scheme to include consumer protection on prepaid access cards, gift cards, and mobile billing). For an illustration of the drastic discrepancies in consumer protection based on the funding mechanisms, Michelle Jun, Consumers Union, Mobile Pay or Mobile Mess: Closing the Gap Between Mobile Payment Systems and Consumer Protections 6-14 (2011) arguing that the same consumer protections afforded credit cards and debit cards be extended to prepaid access funding mechanisms.
regulation pertaining to consumer protection defers to the states if a state has money transmitter laws that regulate consumer liability for fraudulent or unauthorized transactions. Many times these regulations apply to entities operating within the state or even internationally, as anyone offering money transmitter services to any person within the state falls under that state's jurisdiction.

Crime prevention at the state level exists primarily to ensure compliance with licensing requirements to bolster consumer protection against fraud and unauthorized transactions. However, some states have amended their statutes to include anti-money-laundering provisions similar to those found at the federal level.

B. Structure

Most state statutes broadly define money transmitters and commonly include any entity that receives monetary value for the purposes of transmission to another entity or location. However, the language used in each state's applicable statute varies considerably.

77. 12 C.F.R. § 1005.6(b)(6) (2013) (explaining that any state law or financial institution agreement with the consumer that caps liability at a lesser amount then the amount given in 12 C.F.R. 1005.6(b)(1)-(3) will govern the transaction).

78. See, e.g., N.C. GEN. STAT. § 53-208.3(c) (2012) ("For the purposes of this Article, a person is considered to be engaged in the business of money transmission in this State if that person makes available, from a location inside or outside of this State, an Internet website North Carolina citizens may access in order to enter into those transactions by electronic means." (emphasis added)).

79. See, e.g., id. § 53-208.26 (criminalizing those who operate without licensee by the state or who knowingly and willfully take action with the intent to deceive the consumer, and laying out the criminal penalties for noncompliance in North Carolina).

80. See TEX. FIN. CODE ANN. § 156.602 (West 2012) (requiring compliance with the BSA and the U.S. Patriot Act); see also Broox W. Peterson, So You Want to Start a Payments Company?, PAYMENTSVIEW.COM (Aug. 13, 2012), http://paymentsviews.com/2012/08/13/so-you-want-to-start-a-payments-company/ (discussing the adoption of anti-money laundering statutes at the state level).

81. Compare DEL. CODE ANN. tit. 5, §§ 2303 (West 2012) (providing no explicit definition of a money transmitter but requiring a license for anyone who is engaged in the “business of selling checks, or issuing checks or engage in the business of receiving money for transmission or transmitting the same...”)(emphasis added), and N.Y. BANKING LAW § 641(1) (including no specific definition of money transmission but requiring a license for anyone engaged in the “business of selling or issuing checks, or engage in the business of receiving money for transmission or transmitting the same”), and CAL. FIN. CODE § 2003(s) (West 2012) (including no specific reference to money transmitters but defining the reception of money 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”), with FLA. STAT. § 560.103(23) (2013) (defining money transmitters as any organization or individual
California has one of the broadest definitions, which includes any entity that (1) sells or issues payment instruments or stored value, or (2) receives money anywhere within the United States and subsequently transmits a monetary value anywhere in the world.\textsuperscript{82} On its face, this statute could pertain to any individual who receives money and later sends that money elsewhere, regardless of the purpose. In contrast, Florida utilizes a construction similar to the federal definition, classifying money transmitters as MSBs and defining them as any entity, foreign or domestic, licensed within the state to receive currency, monetary value, or other payment instruments by any means, and transmitting them via courier, the Internet, bill payment services, or other businesses that facilitate transfers.\textsuperscript{83} In deciding whether an entity meets the definition of a money transmitter for each state, not only does the everyday interpretation of the language cause confusion, but the lack of uniformity also can prove troubling for businesses trying to operate in multiple states.

Wide variety exists among the states over the types of entities that are exempt from the state statutory schemes. Even where the language of the exemption is similarly worded between states, it is often the case that the interpretation and application create strikingly different results. Most states have general exemptions for: (1) any entity already regulated under state law or the federal law, such as a bank, bank holding company, or credit union; (2) any agency of a state government or the United States or instrumentality thereof; and, (3) anyone to whom the commissioner, or the equivalent position, of the controlling agency grants an exemption.\textsuperscript{84}
Many states, including North Carolina, also have an exemption for any entity acting as an agent or delegate of a licensee. Without more, the language of the various statutes containing this type of exemption suggest they would not exempt mobile payment businesses because a mobile payment business would be providing services on behalf of customers and merchants, not for other money transmitters. However, some states interpret this exception differently. For example, in Texas, although a mobile payment service would likely meet the definition of a money transmitter—which otherwise requires licensing to be able to operate in Texas—the Texas Banking Commissioner has held that anyone who is under contract with a merchant to provide payment services is acting as an agent to a merchant, and is therefore exempt, subject to certain stipulations.

It is important to note that the Texas Banking Commissioner does not specifically exempt the payment processor under the agency clause in the specified exclusions, but rather construes this sort of business as not “receiving” funds because it meets an exception to what constitutes a “payment instrument.” Similar to Texas, New York

85. See, e.g., TEX. FIN. CODE ANN. § 151.003(5) (providing an exemption for anyone acting as an agent of a federally insured financial institution); CAL. FIN. CODE § 2003(b) (defining an agent as an entity that provides money transmission services on behalf of a licensee so long as the licensee is liable for the monetary value from the time the money is received by the money transmitter from the financial institution); DEL. CODE ANN. tit. 5, §§ 2303, 2311 (exempting any agent of a licensee from maintaining a license so long as the licensee has recorded the agent with the state commission); N.C. GEN. STAT. § 53-208.4(b) (exempting any authorized delegate, subject to contractual stipulations, which insures that the licensee maintains liability).

86. See, e.g., CAL. FIN. CODE ANN. § 2010(h) (West 2012) (excluding any agent of a licensee).


provides an agent of a licensee exemption but also includes an "agent to a payee" exemption.\textsuperscript{89} Although the term "agent of payee" is not explicitly described anywhere in the statute, the New York Department of Financial Services issued opinions indicating that mobile payments businesses could be exempt subject to certain stipulations.\textsuperscript{90} Specifically, a mobile payment business (agent) would need a contract with each merchant (payee) authorizing the mobile payment business to receive and transmit funds on behalf of the merchant.\textsuperscript{91} The contract also must establish that payment from the customer to the mobile payment business constitutes payment to the merchant regardless of whether the merchant actually receives the funds.\textsuperscript{92} These contractual obligations between the merchant and the mobile payment business ensure that the customer is not under any increased risk of loss from fraudulent or unauthorized transactions.\textsuperscript{93}

V. BARRIERS TO ENTRY

A. \textit{Navigating the Complex System of Federal and State Regulatory Schemes}

The system of federal and state regulations is intricate and complex and creates barriers to entry into the mobile payments sphere for many companies.\textsuperscript{94} For a startup company, determining whether it meets one of the exemptions under federal regulation is extremely

\textsuperscript{89} N.Y. BANKING LAW \textsection{641.1} (McKinney 2013) (requiring all money transmitters to be licensed agents of licensees or agents of payees).


\textsuperscript{91} See id. (determining that a merchant issuing prepaid student cards who received money and transmitted that money to a card issuing bank to settle all charges was exempt because they were under contract with the card issuing bank, they gave receipt to the customers, and payment to the merchant was considered payment to the card issuing bank such that the consumer was under no increased risk of loss).

\textsuperscript{92} Id.

\textsuperscript{93} Id.

\textsuperscript{94} Sean Sposito, \textit{How California Law Put a Hot Payments Innovator on Ice}, \textit{Am. Banker}, Aug. 6, 2013 (describing the recent laws enacted in California and the hardship it has created on start up companies).
difficult. However, given the encompassing language of the statutes, it is a safe assumption that most new payment companies that operate across state lines will be subject to federal regulation. In addition, states vary widely on what classifies as a money transmitter and in the scope of exemptions to regulation under a particular state’s law. Having to apply and be licensed in each individual state that has money transmitter laws is certainly no easy process, even for large companies.

B. Licensing Fees and Expenses

In addition to the problem of navigating federal and state laws and complying with all reporting requirements therein, a potentially bigger problem exists: namely, the cost of being licensed in multiple states and federally, maintenance of that license, and compliance with the plethora of regulations. The expenses incurred during the licensing application and review process at the state level can be an insurmountable barrier to entry for many small companies. Most states have an application fee, ranging from $50 to $3,750, and annual licensing fees ranging from $100 to $6,000. Additionally, most states require a company to have a net worth ranging from $5,000 to $1,000,000. Most states also require the company to post surety

95. See Peterson, supra note 80 (explaining the difficulties of navigating the complex web of regulations).

96. See The Future of Money: Where Do Mobile Payments Fit in The Current Regulatory Structure? Hearing Before the Subcomm. on Fin. Insts. and Consumer Credit of the H. Comm. on Fin. Servs., 112th Cong. 4 (2012) [hereinafter The Future of Money] (statement of James H. Freis, Jr., Director, Fin. Crimes Enforcement Network (FinCEN), U.S. Dep’t. of the Treasury) (“FinCEN’s regulations make it clear that the acceptance of funds from one person and then the transmission of those funds to another person or location by any means constitutes money transmission and that any person doing business in whole or in part in the United States who engages in money transmission, regardless of other business lines such as telecommunication services, would likely be a money services business subject to FinCEN’s regulations, and as such must register and comply with all requirements applicable to a money transmitter.”).

97. See Nat’l Conference of Comm’rs on Unif. State Laws, supra note 76, at 1 (describing the discrepancies in state regulation among jurisdictions); see Peterson, supra note 80.

98. See Aaron Greenspan, Think Computer Corp., Held Hostage: How the Banking Sector Has Distorted Financial Regulation and Destroyed Technological Progress 8-10 (2011) (providing an overview of state money transmission fee requirements for each state).

99. See id.

100. See id. at 8.
bonds, ranging anywhere from $1,000 to $7,000,000.\textsuperscript{101} Aggregating all these fees, it is estimated that a money transmitter would incur costs of over $300,000 to operate in every state per year regardless of the size of the company.\textsuperscript{102}

On top of the costs to operate in multiple states, the costs associated with complying with the federal anti-money-laundering requirements imposed under the BSA can be significant. Depending on the size of the MSB and the volume and size of transactions they handle, there may be significant expenditures devoted to compliance officers, investigators, and record maintenance and reporting.\textsuperscript{103} This is especially relevant in light of the fact that federal prosecutors have begun to bring criminal charges against numerous MSBs for failing to maintain an adequate AML program.\textsuperscript{104}

VI. CURRENT ATTEMPTS AT RESOLVING STATE REGULATORY PROBLEMS

The barriers to entry created by the complicated system of regulation at the state and federal levels, as well as the significant fees associated with the state licensing systems, are detrimental to innovation and the economy at large. A unified system of fees and regulations would solve a majority of these problems and erode many of the barriers to entry. Currently there is no national licensing standard for money transmitters to follow at the state level,\textsuperscript{105} nor any centralized agency for every state to streamline application, licensing, review, and fee structures. However, some organizations have tried to alleviate many of the burdens of the regulatory system in various ways. While the steps taken thus far are generally positive, there are still many improvements that can be made.

\begin{itemize}
  \item \textsuperscript{101} See id. at 9; \textsc{Cal. Fin. Code} § 2037(e) (West 2013) (requiring up to $7,000,000 in surety bonds).
  \item \textsuperscript{102} See \textsc{Greenspan, supra} note 98, at 9.
  \item \textsuperscript{103} See Robert Anello, \textit{Financial Institutions: How Much More Will You Have To Spend On Anti-Money Laundering Programs to Avoid Criminal Prosecution?}, \textsc{Forbes.com} (Oct. 24, 2012), available at http://www.forbes.com/sites/insider/2012/10/24/financial-institutions-how-much-more-will-you-have-to-spend-on-anti-money-laundering-programs-to-avoid-criminal-prosecution/ (noting that some financial institutions already spend over $100 million annually on anti-money laundering programs and are likely to spend more in light of these recent developments).
  \item \textsuperscript{104} See id.
  \item \textsuperscript{105} See Peterson, \textit{supra} note 80 (explaining the difficulties of navigating the complex web of state regulations).
\end{itemize}
A. Unifying the Structure of the Regulatory System

In 2001, the National Conference of Commissioners on Uniform State Laws (NCCUSL) issued the Uniform Money Services Act (UMSA), which as of 2013, has been adopted in whole or in part by eight states.\textsuperscript{106} In an attempt to bring down the barriers to competition and reduce the burden of multi-state compliance issues, the UMSA created a unified code that clearly defines the relationship between MSBs, and creates uniform reporting and record keeping requirements.\textsuperscript{107}

The UMSA is progressive in many respects because it accounts for Internet systems, mobile payment businesses, and stored or prepaid value card companies.\textsuperscript{108} For businesses who offer multiple kinds of services—such as Google, PayPal, or Square, who all offer mobile wallets, marketplaces, and card reading technology—the UMSA has an activity-based approach whereby issuers of prepaid value as well as money transmitters are all grouped together because they pose similar risks to the consumer.\textsuperscript{109} The UMSA also advocates for reciprocity between states whereby any MSB licensed in one participating state does not have to become licensed in another participating state, subject to certain bonding requirements.\textsuperscript{110} It is not readily apparent why more states have not adopted certain sections of the UMSA that clarify and streamline otherwise convoluted areas of regulation.


\textsuperscript{108} See Nat’l Conference of Comm’rs on Unif. State Laws, supra note 76, at 1-13, 52-55.

\textsuperscript{109} See id. at 19.

\textsuperscript{110} See id. at 32 (permitting a multistate MSB to only be licensed in one participating state, subject to approval by that state’s superintendent, and certain other bonding and reporting requirements).
B. Unifying the Licensing Process

The Money Transmitters Regulatory Association (MTRA) has created a uniform renewal application for licensees that operate in multiple states to ease the burden of annually renewing in each state that the MSB operates in.111 Similar to the MTRA, the Nationwide Mortgage Licensing System (NMLS), created by the Conference of State Bank Supervisors (CSBS),112 is an organization consisting of state regulators who have agreed to create and operate an internet platform allowing MSBs to apply, update, and renew all state money transmitter licenses for every state participant of the NMLS. 113 The NMLS charges a flat fee for processing each MSB’s application.114 The NMLS does not grant or deny licenses, but merely processes the applications and distributes them to every state requested by the particular MSB for the state to ultimately grant or deny the license.115

C. Proposed Changes

The changes proposed herein to current state level regulatory systems address the exemption systems, and fees and expenses incurred through the licensing and bonding requirements. Furthermore, the

111. See MONEY TRANSMITTER REGULATORY ASSOCIATION, http://www.mtraweb.org/ (last visited Nov. 22, 2013) (describing the goal of the MTRA to be to create a unified system to efficiently examine multistate money transmitters).

112. What is CSBS?, CONFERENCE OF STATE BANK SUPERVISORS, http://www.csbs.org/about/what/Pages/default.aspx?PF=1 (last visited Nov. 24, 2013) (explaining that they are a professional agency helping to provide oversight on state regulatory issues).

113. Press Release, Conference of State Bank Supervisors, Ten More States to Use Uniform Mortgage Test; 30 States Now Using the Test (July 1, 2013), available at http://www.csbs.org/news/press-releases/2013pr/Pages/pr070113.aspx (“The Nationwide Mortgage Licensing System and Registry (NMLS) is a web-based system that allows state-licensed non-depository companies, branches, and individuals in the mortgage, consumer lending, money services businesses, and debt collection industries to apply for, amend, update, or renew a license online for all participating state agencies using a single set of uniform applications.”).

114. Money Transmitter/Currency Exchange: NMLS Transition FAQs, WASH. STATE DEPT. OF FIN. INSTS. (Dec. 6, 2013), http://www.dfi.wa.gov/cs/money-services-nmls-transition-faq.htm (noting that the NMLS charges $100.00 annually per company for processing fees).

115. About NMLS, NATIONWIDE MORTG. LICENSING SYS. & REGISTRY, http://nationwidelicensingsystem.org/about/Pages/default.aspx (last visited Jan. 22, 2014) (explaining that the NMLS only processes the application and cannot admit or deny a license).
proposed changes are also compared to the current, largely unaccepted UMSA.

Instead of focusing solely on the medium of transfer, a state statute should focus on the underlying function of the entity in a holistic manner. In doing so, the statute will continue to cover the necessary entities, while eliminating confusion as to whether a particular method of transmission or a particular category of monetary value falls under the definition. Both the federal definition of money transmitters under MSB and the UMSA provide great examples of flexible statutory standards that can account for traditional and novel forms of monetary transmission. 116 By focusing on the overall function, the statute most likely can account for any new technology that provides innovative mechanisms but also can serve similar purposes as more traditional mechanisms.

One of the biggest problems of currently enacted systems is discerning whether an exemption from the definition of “money transmitter” should be granted. In addition to the standard three categories of exemptions, there needs to be an exemption for companies that provide a valuable money transmitter service, yet do not increase consumer risk. Agent or delegate exemptions seem logical, but the current language of most of the state statutes provide convoluted descriptions of what constitutes an exempt agent. 118 The UMSA proposes exemptions for anyone who provides clearance or settlement services for banking entities or other entities already regulated under

116. See The Future of Money, supra note 96, at 10 (“Recognizing that payment systems evolve rapidly, FinCEN took a comprehensive approach in this area, revising its regulations 1 year ago specifically to cover mobile payments and other innovations. The rule was developed to be technologically neutral and hopefully cover new developments for years to come. Specifically, the rule focuses more on the underlying activity as opposed to the particular electronic communication vehicle. If a mobile phone allows person-to-person payments or payments that cross borders in or out of the country, then the provider must identify the customer, keep records of transactions, and have procedures in place to report to FinCEN possible money laundering or other suspicious activity.”); see also NAT’L CONFERENCE OF COMM’RS ON UNIF. STATE LAWS, supra note 76, at 1-13, 52-55.

117. The three general categories of state exemptions are: (1) government agencies or instrumentalities of state or federal government, (2) commissioner determinations, and (3) entities already regulated under state or federal law.

118. See TEX. DEPT. OF BANKING, OP. NO. 06-01 (2006) (citing TEX. DEPT. OF BANKING, OP. NO. 03-01 (2003)) (noting that the Commission of Banks exempted the particular agency not under the specified exemptions but rather because of the types of funding instruments they dealt in); TEX. FIN. CODE ANN. § 151.301(6)(A) (2012) (“‘Payment Instrument’ . . . does not include an instrument, service, or device that: [] transfers money directly from a purchaser to a creditor of the purchaser or to an agent of the creditor.”).
other federal regulatory schemes, or agents of someone already licensed under the money transmitter laws of that state.\textsuperscript{119} Ideally, a statute should also specify that any agent for a licensee, payee, seller, or any other regulated entity could be exempt subject to certain stipulations. These stipulations include: (1) the mobile payment service or MSB is under contract with the merchant, seller, or licensee to receive and transmit funds directly involved in facilitating a transaction on their behalf; (2) payment to the agent (the MSB) from the customer is considered payment to the merchant, regardless of whether the merchant actually receives the monetary value; and (3) the consumer is at no increased risk of fraud or unauthorized transactions. The implementation would require only minimal changes in most state statutes, as most states could simply alter the term "licensee" to include merchants or sellers who are already under government regulation and who assume liability for faulty transactions.\textsuperscript{120}

One of the greatest burdens to mobile payments businesses are the fees and expenses incurred by money transmitters who operate in multiple states. Adopting the proposed exemptions and definitions would largely serve to eliminate many of these fees. For example, state net worth and surety bond requirements are generally for the benefit of individual claimants who are looking for redress from the money transmitters for a failed or unauthorized transfer or some other fraudulent activity that can be traced to the money transmitter in that state.\textsuperscript{121} However, they do not promote consumer protection when the mobile payment business is not liable and do not add any increased consumer risk to the transaction.\textsuperscript{122} In a unified system, these burdens could largely be erased. Specifically, the net worth and surety bonding requirements would be eliminated depending on the structure of the entity. If the money transmitter were under contract with the merchant or any participating banks, and operated merely to facilitate the

\begin{itemize}
\item[119.] NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS, supra note 76, at 23-24.
\item[120.] See, e.g., N.C. GEN. STAT. § 53-208.4(b) (providing exemptions only for agents of licensees).
\item[121.] See id. § 53-208.8 (stating that the surety bond "shall run to the State for the benefit of any claimants against the licensee to secure the faithful performance of the obligations of the licensee with respect to the receipt, handling, transmission, and payment of money or monetary value in connection with the sale and issuance of payment instruments, stored value, or transmission of money").
\item[122.] See GREENSPAN, supra note 98, at 13 (explaining that surety bonds and net worth requirements are largely ineffective at promoting consumer protection).
\end{itemize}
transaction either through mobile wallets or marketplaces or a similar technology, the net worth and surety bonding requirements would be severely curtailed, if not eliminated outright, as there is no increased risk to the consumer because liability is contractually bestowed to the merchant or participating bank.\textsuperscript{123} Furthermore, as a practical matter, FDIC pass-through insurance covers customers when nonbank mobile payments businesses aggregate individual deposits and invest them in banks.\textsuperscript{124} If the money transmitter provided a service whereby the consumer was put at an increased risk of loss or fraudulent activity because of the money transmitter, then licensing would be required as they would not be exempt as an agent. However, for nonbank entities operating as MSBs—especially issuers of prepaid or stored value cards, in light of the fact that no federal regulation provides consumers for fraudulent transactions with these—states need a unified policy of surety bonds or net-worth requirements to ensure that the consumer has adequate coverage in the event of a fraudulent transaction.\textsuperscript{125} The UMSA provides a sensible option requiring a surety bond equal to liabilities.\textsuperscript{126} However, the licensing fees still exist for each state that a MSB operates in, even with the NMLS providing a streamlined, centralized application process. The USMA proposes reciprocity to combat this problem, which would largely eliminate licensing fees because a MSB would only have to pay licensing fees in one state, assuming other states that they operated in had adopted the USMA reciprocity agreement.\textsuperscript{127} Furthermore, because the UMSA still requires

\textsuperscript{123} See Terms of Service – US Buyer, supra note 2, § 3.2 (“You acknowledge and agree that your purchases of Products are transactions between you and the Seller, and not with GPC, Google or any of their affiliates. Neither GPC nor Google are a party to your Payment Transaction for the purchase of Products, and GPC, Google, or other GPC affiliates are not a Buyer or a Seller in connection with any Payment Transaction, unless expressly designated as such in the listing of the Product on a Google Web Site.”); see also Kevin V. Tu, From Bike Messengers to App Stores: Regulating the New Cashless World, 65 ALA. L. REV. 77, 129 (2013) (arguing that “agent of the payee” system whereby money transmitters who are under contract with a merchant and who do not pose any increased risk to the consumer, should be construed as being exempt from licensing).

\textsuperscript{124} See Pew Charitable Trust, supra note 65, at 9-10.


\textsuperscript{126} See Nat’l Conference of Comm’rs on Unif. State Laws, supra note 76, at 33-34.

\textsuperscript{127} See id. at 31-32.
the MSB to pay fees in the state they are licensed in, the competition between states to entice MSBs to become licensed in their state would drive down the prices of licensing, benefitting MSBs. Alternatively, a centralized state regulatory system, such as the NMLS, with increased authority to issue or deny licenses, could significantly reduce the fees by consolidating both the application fee and the licensing fee into one reduced fee. Moreover, because the requirements for licensing would be clear and uniform, MSBs could focus on their bottom line instead of their licensing issues.

Admittedly, the difficulty in adopting a uniform code of regulation is great. It is not usually the case that a state would enjoy a short-term loss in revenue from the reduction in fees associated with the licensing requirements for MSBs. However, the benefits of uniformity help all parties involved. Short-term losses at the state level could gradually be eliminated because the increased success of MSBs would benefit the states and their economies in the long run.

VII. CONCLUSION

The rise in novel payment systems has created an increasingly difficult regulatory task for both federal and state governments in the United States. Current regulation at the state level is largely outdated and ineffective. The constant battle between innovation and regulation has created negative consequences throughout the nation. Not only is the dual system of regulation increasingly difficult to navigate, but the fees and expenses associated with the state licensing system are burdensome for small businesses looking to operate in multiple states. These barriers to entry and operating can be largely eliminated while maintaining consumer protection and crime prevention, by adopting portions of the UMSA and the proposed changes provided herein. The necessary steps are not drastic, as a majority of state statutes would only require minimal statutory amendments. Not only would these changes reduce fees, but they also would create a more adaptable system, capable of effectively regulating new technologies while not hindering innovation.

M. MACRAE ROBINSON