

Podcast: Deep Dive Into Payments: Impacts of Money Transmission Laws

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The next item in McGlinchey's [Deep Dive into Payments Series](#) is a podcast on money transmission by attorneys **Jeff Barringer**, **Amy Greenwood-Field**, and **Aaron Kouhoubt**. Their discussion centers around the impacts of money transmission laws on those in the payments space who find themselves in the flow of funds or providing any payment services to third parties. They delve into the Model Money Transmission Modernization Act, FinCEN regulation exemptions, and options for startup businesses.

Aaron Kouhoubt: I'd like to welcome everyone to our next series in the Deep Dive on Payments. I'm Aaron Kouhoubt, and I am a Member in the Cleveland office of McGlinchey in the Consumer Financial Services Group. I am excited to be joined today by Jeff Barringer and Amy Greenwood-Field, who are both Members in the McGlinchey Consumer Financial Services team. And they're here today to talk about money transmission and how it interplays within the payments space, which is really something that, I am happy to admit, prior to maybe three or four years ago, I never really considered money transmission when thinking about the payments space and how it works. But really, we see clients all the time that are within the flow of funds in some way. They're acting as a third party, they are servicing a loan, maybe they are acting as a payment processor in between, maybe they're just inserting themselves such that they're receiving funds from a party and sending them to another party.

One thing that we need to think about is that, if that's true, and you find yourself in a business model where you're in receipt of funds, and those funds are being sent to somebody else, that can raise some money transmission issues. And Jeff, what are some of the things that you would think about when looking at your business model and seeing that you might be inserting yourself or accidentally inserting yourself into that flow of funds?

The United States operates underneath a dual level system, so it's not just a registration required at the FinCEN level to operate as a money services business in the United States, but there's also some sort of money

transmission licensing or registration trigger in every state except for Montana and every U.S. populated territory.

Jeff Barringer: Yeah, I think that hits the nail on the head is, one of the primary licensing triggers when you review statutes subject to exemptions that might be available, which we'll touch on probably in a bit, is the receipt of money for the purposes of making the money available in another place or at another time. And so if that's the core definition of what a money transmitter is, if you're in the receipt of funds, then you may need a money transmitter license, and as a result, figure out where you sit relative to that flow of funds to determine whether or not it's a licensing trigger, and you need to dig deeper for available exemptions.

Aaron Kouhoup: Amy, if I've sort of looked through and I feel comfortable that I know the Treasury Department's Financial Crimes Enforcement Network (FinCEN) Regulation and I went through the FinCen Reg, and I don't need to register as a money service business under federal law, can I take that and say, "yeah, I'm good"?

Amy Greenwood-Field: I would be very leery of doing that. Unfortunately the United States operates underneath a dual level system, so it's not just a registration required at the FinCEN level to operate as a money services business in the United States, but there's also some sort of money transmission licensing or registration trigger in every state except for Montana and every U.S. populated territory.

In the FinCEN regulations, there's an exemption for a party that's providing payment processing for a provider of goods or services. The equivalent to that when we talk about state licensing ... typically what we're talking about is an agent of the payee exemption. Only about half the states have an explicit statutory agent of the payee exemption, and there are specific conditions that need to be satisfied for the agent of the payee exemption to be available. Some states require the agent to give a receipt ... for the agent of the payee exemption to be available.

Aaron Kouhoup: Is it accurate to say that the way in which those states sometimes define the activity itself, and/or exemptions that we'll talk about in a little bit, can vary significantly from what the federal government is looking at?

Amy Greenwood-Field: Yes, absolutely. And to be fair, it's not just money as we think about it, it's also, underneath many of the statutes, it's defined as "other monetary value." So I have a fair number of clients that pull in cryptocurrency or other types of value into the money transmission space as well, which I know is not our focus here, but it's something to take into consideration.

Aaron Kouhoup: Yeah, no, I think it's a great point, because we are seeing more of that in various ways. Either crypto reward products or accepting crypto, or, I can go downstairs and withdraw crypto from an ATM machine downstairs. I'm not sure how it works, but you can do it somehow. And so thinking about the fact that it's not just cash, and what we think about as "cash," I think is really important.

Jeff Barringer: I just have one prime example of the overlay between FinCEN regulations and state law. One is in the FinCEN regulations, there's an exemption for a party that's providing payment processing for a provider of goods or services. And the equivalent to that when we talk about state licensing, there's maybe one or two

states with a specific payment processor exemption, but typically what we're talking about is an agent of the payee exemption. Only about half the states have an explicit statutory agent of the payee exemption, and there are specific conditions that need to be satisfied for the agent of the payee exemption to be available. And those conditions are, I would say, common amongst the states. But there are certain differences, whereas, like some states require the agent to give a receipt regarding the receipt of the funds or the monetary value for the agent of the payee exemption to be available, which you need to be aware of if you're a payments provider relying on an agent of the payee exemption, in order to make sure you build that into your consumer-facing experience.

There is currently a Model Money Transmission Modernization Act effort. So it's a joint effort: there was a committee between states and industry and regulators to come up with a model law for money services businesses, and agent of the payee is one of the standard exemptions. So as states are adopting that Model Law ... we are seeing that we are adding more states to that list.

Amy Greenwood-Field: The great thing about agent of the payee is there is currently a Model Money Transmission Modernization Act effort. So it's a joint effort: there was a committee between states and industry and regulators to come up with a model law for money services businesses, and agent of the payee is one of the standard exemptions. So as states are adopting that Model Law, in whole or in part, we are seeing that we are adding more states to that list that Jeff mentioned.

Aaron Kouhoup: Yeah, thank you. Great. If one trigger is, I'm receiving money from one party and sending it to another party, right, at its most basic sense? What if I'm in a situation where I'm a service provider, I have an interface, an app, a website, something along those lines, and it appears to a consumer that is what I'm doing. What if I'm holding myself out to the public, even if my technical process in the back is that I'm not receiving funds (and we'll talk about some of those alternative arrangements), but is there any implication to holding yourself out to the public as a money transmitter?

Jeff Barringer: So, in my experience reviewing state statutes and regulations in the licensing space, in and of itself, holding oneself out is engaging in licensable activity. At a minimum, it may result in additional inquiry from state regulators that come across your app or your site, but in addition, that in and of itself may be a codified licensing trigger within the state statutes and regulations. So what we see and what we tend to do for clients that optically look like they're in the money transmission space, even though they're not within the flow of funds, is you'll see fine print and disclaimers and disclosures regarding, like "powered by XYZ," the app provider, and then a disclosure as to how the flow of funds actually works and who's the party providing funds, whether a bank partner or a dual licensed money transmitter that the app provider has partnered with to facilitate that flow of funds.

One of the important things to look into there is account access. Who has access to the account and who owns the account and whose benefit the account is established for? And so getting the wrong type of account could still result in you needing to be a licensed money transmitter in some states, and your account access could lead to you being required to be licensed as a money transmitter.

Aaron Kouhoup: So, as I understand it, you find yourself in a position where you need a license to do this, you have business partners, or you have outside partners that want to move quickly and get out to market with a product, or you're already maybe doing it, and you've realized that maybe there's something here that you need

to think about. My understanding is that the licensing process can take a while, and if that is accurate, are there any other things that can be thought about? Are there any ways that you can maybe think about the product, any ways that you can get out to market with a different structure while you are either waiting for a license or determining what license you might need? Because the reality is maybe you don't have six to nine months to wait for a license to get approved.

Amy Greenwood-Field: Yeah, absolutely. It's not unusual for our clients to partner with either a financial institution to actually receive and hold funds on their behalf in a segregated account, and/or, as Jeff alluded to, partner with a licensed third party to handle those funds flows for them as well.

Jeff Barringer: There are other strategies that we have used with clients. One would be a heat map, so which states have an agent of the payee exemption? If you're a payment processor and would generally be viewed as an agent via contractual relationship with the provider of goods or services, then the agent of the payee exemption gets you about halfway across the country. And then so you might go piecemeal in order to get full coverage where you're acting as an agent of the payee in states where you're able to be an agent of the payee, based on the applicable exemptions or common law exemptions, and then getting a license in the states where you need to be licensed. And that would essentially cut your licensing posture in half, where you would end up with a license in only about half the states. Other things that Amy alluded to is essentially being the app provider and partnering with a financial institution, and allowing the financial institution to be the party that's providing the actual transmission and movement of funds.

If you are engaged in money transmission and are required to have a license by a state and don't have that license, it's a federal crime to engage in money transmission without a license.

Jeff Barringer: One of the important things to look into there is account access. Who has access to the account, who owns the account, and whose benefit the account is established for? And so, getting the wrong type of account could still result in you needing to be a licensed money transmitter in some states, and your account access could lead to you being required to be licensed as a money transmitter. Of course, you know, the flip side of that is, making changes to the type of account that you have through which funds flow can be a way to change your posture such that you wouldn't need a license. So one of the accounts that we sometimes see is For Benefit Of (FBO) accounts being used for that purpose.

Aaron Kouhoup: So if this were a board presentation, I would start with the attention-grabbing, exciting, what you might care about, which is, why do I care? What is the implication of conducting, moving money, or holding myself out as moving money and not having a license? Does it, outside of being a technical violation of law, am I getting my wrist slapped? Am I having my doors shut down? Am I going to jail? What's the implication?

Amy Greenwood-Field: There are certainly criminal penalties built in, and you have to remember again that you're looking not just at the federal level but also at each individual state where you may have a consumer.

Jeff Barringer: Yeah. And, at the federal level, one thing to note is, notwithstanding the fact that you may be exempt from registration with FinCEN as a Money Service Business (MSB), if you are engaged in money transmission and are required to have a license by a state and don't have that license, it's a federal crime to engage in money transmission without a license.

There's lots of ways that you might be involved. At a minimum, you should be thinking about these money transmission issues, whether you need a license.

Aaron Kouhoup: And engaging in that activity without a license would not only subject you to potential criminal penalties, but what about, are there any sort of civil money penalties, monetary obligations, anything that would hit the pocketbook?

Jeff Barringer: Yeah, in an enforcement action or a settlement consent, the money that may need to be provided to a state regulator to settle an enforcement action can be significant. The other thing that may hit your pocketbook in two ways comes from the impact on future growth. So if your business plan requires you to have a money transmitter license and you engage in prior unlicensed activity, a state may not provide that license to you. And then second, if a state provides that license to you, they may require you to enter into a consent order as a condition of granting that license. And the money that we have seen paid in connection with those type of consent orders as conditional licensure can sometimes be significant, particularly for a startup.

Aaron Kouhoup: Thank you. So it sounds, at a minimum, if you're sitting back and looking at either your existing model or you're looking to get into business, and you are in any way really inserting yourself into a flow of funds where you're receiving money, you're sending money to somebody, maybe you're retaining a little bit of money and sending some of the other money out, right? There are lots of ways that you might be involved. At a minimum, you should be thinking about these money transmission issues and whether you need a license. I would assume that there are some substantive requirements that come with it as well. So you're not just getting licensed, but you also have some substantive rules that you need to follow: it might be providing a receipt, it might be record-keeping requirements. I would assume that there are some substantive things you have to think about as well.

Then you have all the other things that go with holding the license. You have to maintain proper net worth, you have to have audited financial statements, surety bond providers, just all the things that go with obtaining that actual license to operate.

Amy Greenwood-Field: Yeah, absolutely. We are seeing more standardization in receipt requirements. You mentioned that as an example, in addition to having to provide, if you advertise in a foreign language, you have to also offer the receipts and contracts in that foreign language as well. So that's also part of that Model Law effort. So I think that we're going to see more states move that way. And then you have all the other things that go with holding the license. You have to maintain proper net worth, you have to have audited financial statements, surety bond providers, just all the things that go with obtaining that actual license to operate.

Aaron Kouhoup: Any other considerations that people who might be looking to enter this space should be thinking about, as it relates to money transmission, anyway? Lots of other considerations.

Jeff Barringer: One of the considerations is the scope of the law, not necessarily meaning you're in the flow of funds, but who are you doing it for? For example, there are some states that may have a business-to-business exemption. So non-consumer money transmission doesn't require a license. Or territorial applicability. It wasn't too long ago that licensing was triggered exclusively by having an office or an agent in the state. We've moved away from that over the last two decades quite a bit, where that's not necessarily the licensing trigger. But some

states still require licensing exclusively based on who you're receiving money for and not necessarily where it's being transmitted to. Whereas some states require licensing based on both. If you're receiving money from a person in that state or remitting money to a person in that state, that's the trigger. So it varies by state, and one of the biggest issues is essentially the need to evaluate the requirements of each individual state's laws at this point, which will, in theory, become easier as the Model Law is enacted.

One of the considerations is the scope of the law, not necessarily meaning you're in the flow of funds, but who are you doing it for?

Aaron Kouhoup: Thank you both for your thoughts on this, and it would be probably welcome if we get some sort of Model Law to make it a little bit less sporadic by the states. So I appreciate both of your thoughts.

Amy Greenwood-Field: Yeah, I would say with respect to the Model Law, the challenge we have right now is that some states have done a full repeal and replace, where they have adopted the Model Law in whole. And some states are still of the opinion that their current law is pretty good, and so they've adopted just pieces. So we still have some unintended consequences, I think, of Model Law adoption, but it's definitely an area to watch.

Aaron Kouhoup: Thank you. I appreciate it, and thanks everyone for listening. Any follow-up questions anybody might have, feel free to reach out to any of us, and we'll be happy to help you out.

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