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Model Money Transmission Modernization Act: 12 States Take Action

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Since the beginning of 2023, 12 states – Arkansas, Georgia, Hawaii, Indiana, Iowa, Minnesota, Nevada, New Hampshire, North Dakota, South Dakota, Tennessee and Texas – have passed legislation based, to varying degrees, on the Model Money Transmission Modernization Act (Model Act) developed by the Conference of State Bank Supervisors (CSBS), with input from a working group constituted of industry participants and regulators. These states join Arizona, which replaced its money transmission law with a new statute based almost entirely on the Model Act, and West Virginia, which incorporated substantial elements of the Model Act – both last year.

Overview of money transmission laws and the Model Act

Money transmitters are regulated at the state and federal levels. At the federal level, companies engaged in money transmission are generally subject to anti-money laundering compliance program obligations under the Bank Secrecy Act. Additionally, each US state[1] (with the exception of Montana) regulates money transmission under a state-specific licensing regime. As a result, the regulatory frameworks under which money transmitters operate can vary significantly from state to state. CSBS, which released the Model Act two years ago, drafted it with the goal of creating a single set of nationwide standards and requirements that would be adopted by states, therefore harmonizing the regulation of money transmitters and other similarly situated payments companies.

If broadly and uniformly adopted, the Model Act would standardize definitions applicable to money transmission activity, as well as relevant exemptions from licensing, including an exemption for an "agent of a payee." The Model Act also is intended to eliminate technical differences between states that create unnecessary compliance burdens for companies operating in multiple states – which, in today's environment, encompasses most companies. For example, the Model Act provides a mechanism for streamlining and accelerating the licensing and acquisition of control processes, including standardized determinations of whether an individual or an entity is in "control" of a licensee and therefore subject to a pre-acquisition approval process. (Related to these change of control processes, the Model Act also is intended to standardize required background check and vetting processes.) The Model Act also provides a uniform approach to prudential standards, including the calculations of required minimum net worth and surety bond amounts, as well as the types of permissible investments.

Adoption timetable

In the states that have enacted legislation based on the Model Act, the new laws are starting to take effect. The Georgia, Hawaii, Iowa, Nevada and South Dakota laws became effective on July 1, 2023, Minnesota's law became effective on August 1, 2023, and Texas's law took effect on September 1, 2023. Legislation from the remaining states will take effect in the coming months. Many of the states that adopted substantially all of the Model Act have included a transition period for existing licensees. These provisions generally provide that such companies are not subject to the updated law until their next license renewal, to the extent that it conflicts with the prior law.

State approaches to the Model Act

States have taken varying approaches to implementing the Model Act. Arizona, Indiana, Iowa, Minnesota, Nevada, North Dakota, Tennessee and Texas have each passed legislation that implements substantially all of the Model Act in one bill. With the exception of Iowa, these adoptions were executed by replacing the state's

existing money transmission law in its entirety (or near entirety) with the new law. However, none of these states adopted the Model Act verbatim, and each deviation can impact companies' approaches to managing compliance with money transmission laws on a state-by-state basis.

Other states have only partially implemented the Model Act by selecting certain provisions to incorporate into their existing money transmission laws. Furthermore, some states have implemented different sections of the Model Act at different times. For example, Georgia and South Dakota enacted some elements of the Model Act in 2022, and other provisions this legislative session. And Georgia, like West Virginia last year, also implemented Model Act provisions through regulation. While some elements of the Model Act have been relatively uniformly incorporated into these states' new laws (such as the agent of a payee exemption), in many cases, there is variance in key terms or elements of regulation. The result is that licensed money transmitters – and companies considering applying to become licensed money transmitters – will likely need to continue tracking and managing compliance on a state-by-state basis instead of being able to rely on a single, uniform law.

Below we provide an overview of some key elements of the Model Act and how the various state implementations address each element. Please note that the information provided herein is not intended as a comprehensive account of each new or different provision in each state's money transmission law, and companies should review legislative changes with counsel as appropriate to address their ongoing compliance obligations.

Exemptions

The Model Act contains various exemptions from money transmission regulation. States that adopted the Model Act in place of their existing money transmission laws generally kept each of the exemptions from the Model Act. As a result, the agent of a payee exemption, as set out in the Model Act, is (or will be) law in the 14 states that have enacted Model Act-related legislation (though West Virginia did not conform its existing, similar exemption to the Model Act version of the exemption).

Other notable exemptions, also broadly enacted, include an exemption for a service provider to an exempt bank and an exemption for an entity that processes payments solely between and among exempt entities and/or money transmission licensees. The Model Act also includes a carve-out for firms that process payments between a licensed entity that has directly incurred an outstanding money transmission obligation to a sender and the sender's designated recipient. (Each of these exemptions is subject to specific criteria, and the laws generally provide the state banking department with the authority to require any entity seeking to avail itself of the exemption to demonstrate that it meets such criteria.)

Permissible investments and net worth

One of the foundational elements of customer protection under the state money transmission licensing regimes is the requirement that a licensee must maintain permissible investments that equal or exceed – at all times – the licensee's outstanding money transmission obligations (effectively, the amount of money received from customers for transmission but not yet paid to a designated beneficiary or otherwise redeemed). The permissible investments concept is generally the same in all states that have such a requirement, and it generally requires a licensee to hold funds in relatively low-risk, liquid investments. However, the specific assets and holdings – e.g., money market funds, certificates of deposit (CDs), etc. – that constitute a permissible investment vary significantly under existing laws. The Model Act creates a standardized and modernized list of permissible investments which includes cash (including bank deposits) and cash equivalents, CDs, senior debt obligations from insured deposit institutions, AAA-rated money market funds, US government debt, and irrevocable letters of credit that meet specific and detailed criteria.

Several states have not adhered to the Model Act's list of permissible investments. Georgia, for example, adds a general requirement to maintain permissible investments, but does not define any permissible investments by statute; permissible investments are established by rule, and do not include an irrevocable letter of credit as a permissible investment, as other states have done. Hawaii's new money transmission legislation does not update the state's existing permissible investments definitions. South Dakota adopted the Model Act permissible investments list in its entirety, **except for** a change in the treatment of cross-border outbound payments made via wire. West Virginia largely enacted, through statute and follow-on regulation, the Model Act permissible investments provisions but established a fixed date for the annual expiration of the letter of credit (assuming it is used as a permissible investment).

The Model Act also establishes a single formula for determining the amount of minimum net worth an applicant (and subsequently, a licensee) must maintain at all times. Licensees must hold the greater of $100,000 or 3% of total assets for the first $100 million of total assets, 2% of additional assets between $100 million and $1 billion, and 0.5% of additional assets for more than $1 billion. The Model Act provides a provision expressly authorizing applicable banking department authority (generally, a commissioner) to waive this requirement – in whole or in part – for good cause shown. Some states included this provision, while others (such as Tennessee and Nevada) did not.

Payroll processors

The applicability of state money transmission laws to companies that provide payroll processing services has been in question for a number of years. A handful of states exempt payroll service providers that meet certain criteria, while other states have historically not applied their money transmission laws to payroll providers, and still others have deemed payroll processing to constitute money transmission.

The Model Act attempts to address this inconsistency by expressly defining money transmission activity subject to licensing to include payroll processing, defined in the Model Act as "receiving money for transmission pursuant to a contract with a person to deliver wages or salaries, make payment of payroll taxes to state and federal agencies, [make payments relating to employee benefit plans], or make distributions of other authorized deductions from wages or salaries."

However, only some of the states that enacted Model Act legislation incorporated the express provisions pertaining to payroll processing. The Hawaii and Indiana laws do not expressly include payroll processing services in their respective definitions of money transmission. Similarly, Arizona, which passed the first money transmission law based on the Model Act in 2022, did not include payroll processing in its definition of money transmission.

Other changes

While there are deviations among states that have changed their money transmission laws based on the Model Act, adoption of the new law also has eliminated some unique state requirements. For example, while Georgia still requires background checks to be conducted on the employees of a licensee, licensees now have more flexibility in how they conduct such background checks. In addition, the new Nevada money transmission law has eliminated the former law's requirement that all officers and directors of a licensee be legally authorized to work in the US (thus impacting non-US executives or directors at applicants and licensees).

Virtual currency and digital assets

The Model Act contains an optional article specifically pertaining to the regulation of virtual currency. Unlike the other provisions of the Model Act, this article was not the product of consensus among participants in the CSBS working group. As the commentary to the virtual currency provisions notes, it is "[d]erived from the Virtual-Currency Businesses Act published by the Uniform Law Commission's Uniform Regulation of Virtual-Currency Businesses Act."

Nevertheless, this article would provide for the regulation of covered virtual currency activities under the existing money transmission law (in contrast to states such as Louisiana or New York, which have implemented separate virtual currency licensing regimes). With some exceptions, this section of the Model Act would require entities that exchange, transfer or store virtual currency to register for a money transmission license.

Like Louisiana, the Model Act defines virtual currency as a digital representation of value that is used as a medium of exchange, unit of account or store of value that is not legal tender –whether or not it is denominated in legal tender. As with Louisiana's law and New York's regulations, digital assets issued and usable only in merchant rewards programs or in online games are excluded from the definition. Among the Model Act's virtual currency provisions are requirements that licensees maintain holdings of virtual currency in kind sufficient to satisfy the aggregate entitlements of the licensee's customers to the type of virtual currency.

Of the bills passed this year, only Minnesota's and North Dakota's adopt the Model Act's provision for regulating

virtual currency. Additionally, Texas's new law addresses the regulation of virtual currencies to some degree by defining "stablecoins" as a type of "money" – and therefore requiring persons engaging in covered stablecoin activities to be licensed. The Texas law also permits money transmitters to hold stablecoins as a permissible investment against their stablecoin-denominated obligations. Finally, even in states that have not expressly addressed virtual currency in their Model Act-related legislation, the definition of "receiving money for transmission" includes receiving "monetary value" for transmission. Monetary value is defined by the Model Act as a medium of exchange, whether or not redeemable in money, and many existing state money transmission laws employ a similar definition. The breadth of "monetary value" could be interpreted by a regulator to encompass virtual currencies and other digital assets, depending on how they function.

What should payments companies expect?

Despite the progress made this legislative session, the opportunity for substantial improvement and harmonization remains. As recently passed legislation relating to the Model Act comes into effect and is implemented over the next few months, industry should closely review the changes to the laws in these states and any related guidance issued by state banking departments. Similarly, participants should track developments as more states introduce and potentially enact legislation based on the Model Act.

Note

1. The District of Columbia and US territories, including Puerto Rico, Guam and the US Virgin Islands, also have money transmission licensing laws.

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