FATAL FRAGMENTS: THE EFFECT OF MONEY TRANSMISSION REGULATION ON PAYMENTS INNOVATION

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ABSTRACT

A revolution in payments technology is taking place, as entrepreneurs develop new and innovative ways to send, receive, and store money. However, payment startups are running headlong into a thicket of federal and state money transmitter regulations, which impose costly registration and reporting requirements to prevent money laundering and protect consumers. The regulatory burden is particularly heavy at the state level, since each state defines "money transmission" differently. Payments startups must deal with highly fragmented regulation across states early in their lives, resulting in large and often redundant compliance costs while offering comparatively less marginal benefit to consumers. However, this does not mean that state money transmitter laws should be forsaken or preempted. Instead, the laws should be harmonized and streamlined to make multi-state compliance easier for payments startups, while providing adequate consumer protection and rigorous financial oversight. This Article examines the above issues by focusing on the fragmented landscape of state money transmitter regulation. It further analyzes the costs and benefits of such regulation on startups and consumers, and proposes several modifications to multi-state regulation that could improve the tradeoff between regulatory cost and innovation benefits.

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I. INTRODUCTION

We are witnessing an explosion of payments startups in the United States. As more commercial activity shifts online, payments services both integral and tangential to the commercial activity have grown accordingly. But these payments startups are being halted in their tracks by federal and state money transmitter laws. Traditionally, money transmitters were understood as remittance providers – companies whose main business was helping consumers send and receive money to each other. Western Union and Moneygram are classic examples of money transmitters, and money transmitter laws were drafted with these business models in mind. Unfortunately, the broad language of the outdated statutes, coupled with inconsistent regulatory enforcement across states, has been forced upon payments startups despite their poor fit with modern business models. A "modern" money transmitter could be practically any business moving money on behalf of consumers. This wide net implicates most businesses engaging in e-commerce, such as marketplaces that accept and disburse money for sales, and payment processors who facilitate consumer transactions.

A debate has raged around the impact of broad money transmitter laws. Financial regulators stand on one side, arguing that companies moving large sums of consumer money around need to be monitored for consumer protection and anti-money laundering reasons, even if they don't fit the traditional money transmitter model. Entrepreneurs stand across the aisle, criticizing these regulations for stifling financial innovation. Indeed, the very first panel discussion of 2015 at Money 20/20, the largest payment industry conference in the U.S., was titled "State Money Transmitter Licensing Laws: Are They Killing Payments Industry Innovation?"

In this Article, I answer that question and more. Part II of this Article discusses the structure and complications of money transmitter regulation at the federal and state level. Part III identifies several types of payments startups and draws a crucial distinction between them that should guide the regulatory approach. Part IV assesses the costs and benefits of applying the currently fragmented regulatory regimes to these startups. Part V proposes two approaches that could maximize the innovation benefits of these startups, without losing the important safety valve of regulatory oversight. Part VI concludes.

II. MONEY TRANSMITTER REGULATION IS BROAD BUT FRAGMENTED

A. The Scope of the Federal Bank Secrecy Act is Reasonably Delimited

Money transmitters are regulated at both the federal and state level, but for different purposes. At the federal level, they are subject to regulation under the Bank Secrecy Act (BSA). The BSA was enacted in 1970 to prevent money laundering and focuses primarily on creating a paper trail of all large financial transactions.[1] The Financial Crimes Enforcement Network (FinCEN) is tasked with promulgating and enforcing BSA Rules.[2] FinCEN regulates money transmitters with an eye towards preventing money laundering and terrorist financing.

A wide range of potential money transmitters is subject to regulation because the scope of FinCEN's authority is drawn broadly. FinCEN regulates money services businesses "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, . . . [operating in any of the listed categories]."[3] Money transmitters are one of those categories and encompass any "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."[4] Effectively, any business or person that accepts value from one entity to transmit to another would count as a money transmitter.

Fortunately, FinCEN has spelled out several exemptions from this broad definition. In particular, the Rule exempts a person from money transmitter regulation in six circumstances: 1) providers of network infrastructure to money transmitters; 2) certain payment processors; 3) certain clearance and settlement systems; 4) physical transporters of currency; 5) providers of prepaid access;[5] and 6) persons accepting and transmitting funds only integral to the sale of goods or services.[6] These exemptions carve out businesses that pose lower money laundering risk, again reflecting the BSA's primary focus on preventing money laundering rather than enhancing consumer welfare. FinCEN's basic premise appears to be: if a business transmits funds between well-regulated entities and well-understood channels, it is less likely to require regulation as a money transmitter. Its administrative guidance on the various exemptions supports this view. For example, FinCEN has stated that transporting currency

1 *See* Peter E. Meltzer, *Keeping Drug Money From Reaching the Wash Cycle: A Guide to the Bank Secrecy Act*, 108 BANKING L.J. 230, 231 (1991).
2 *See* 31 U.S.C. § 310 (2012).
3 31 C.F.R. § 1010.100(ff) (2016).
4 31 C.F.R. § 1010.100(ff)(5)(i)(A) (2016).
5 Providers of prepaid access are regulated as a separate category of money services business, and not as a subcategory of money transmitter. *See* 31 C.F.R. § 1010.100(ff)(4) (2016).
6 *See* 31 C.F.R. § 1010.100(ff)(5)(ii)(A)-(F) (2016).

between U.S. financial institutions is exempted, but transporting currency to a foreign bank would not qualify for exemption.[7] As another example, a payment processor using only clearing and settlement mechanisms that admit only BSA-approved institutions (e.g., Fedwire, the ACH network) would qualify for the payment processor exemption. However, if the same transaction also touches on clearing and settlement mechanisms that admit non-BSA-approved institutions (e.g., IBAN wires or more recently, bitcoin exchanges), the exemption becomes unavailable.[8]

This approach has kept the burden of federal compliance directed at those businesses with more immediate money-laundering risk in the form of modern money transmitters (e.g., digital wallets such as PayPal and Venmo).[9] These exemptions arguably operate to exclude certain popular startup models such as gig economy businesses. For example, Uber collects payments from customers to transmit them to drivers, so it might be construed as a money transmitter. But under one line of administrative rulings, the payment processor exemption applies to platforms whose money transmission activities are limited to collecting and remitting payments as an agent of the creditor.[10] This could, in theory, apply to Uber and, at the time of this writing, Uber has not registered as a money services business.[11] Thus, a range of

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7 *See* FINCEN, FINCEN RULING 2004-3 – DEFINITION OF MONEY SERVICES BUSINESS (MONEY TRANSMITTER/CURRENCY DEALER OR EXCHANGER) (Aug. 17, 2004), https://www.fincen.gov/news_room/rp/rulings/html/fincenruling20043.html [https://perma.cc/5Q3S-UZ2Z].

8 *See* FINCEN, REQUEST FOR ADMINISTRATIVE RULING ON THE APPLICATION OF FINCEN'S REGULATIONS TO A VIRTUAL CURRENCY PAYMENT SYSTEM (Oct. 27, 2014), https://www.fincen.gov/news_room/rp/rulings/html/FIN-2014-R012.html [https://perma.cc/2FGE-CCE4].

9 Venmo allows users to "pay anyone instantly using money you have in Venmo" using a mobile app. *How it works*, VENMO, https://venmo.com/about/product [https://perma.cc/9YU2-NNPN].

10 *See* FINCEN, DETERMINATION OF MONEY SERVICES BUSINESS STATUS AND OBLIGATIONS UNDER THE FUNDS TRANSFER RECORDKEEPING RULE, AND REQUEST FOR REGULATORY RELIEF (Nov. 20, 2009), https://www.fincen.gov/statutes_regs/guidance/html/fin-2009-r004.html [https://perma.cc/4JA5-BQAU].

11 *See* FINCEN MSB REGISTRANT SEARCH WEB PAGE, https://www.fincen.gov/financial_institutions/msb/msbstateselector.html [https://perma.cc/8EC3-Q3AW] (An MSB Registrant search for Uber yields no results. This observation is confirmed by payments lawyers specializing in this sector.); Adam Atlas, *2016 Question of the Year: Is there any startup that is not a payments company?*, LINKEDIN PULSE (Dec. 9, 2015), https://www.linkedin.com/pulse/2016-question-year-any-startup-payments-company-adam-atlas?forceNoSplash=true [https://perma.cc/NU6G-ZTFZ].

startups involving payments can avoid FinCEN registration requirements and correspondingly save themselves extensive reporting and recordkeeping obligations. As I will describe in later sections, the same startups may nevertheless be subject to state-level registration and reporting requirements.

Furthermore, forcing startups to register with FinCEN is less likely to have chilling effects on entrepreneurial activity. A simple review of FinCEN's registration database bears out this hypothesis – more than 30,000 businesses or persons were currently registered with FinCEN as money transmitters, ranging from Western Union, to Facebook Payments, to an intriguing company named "1 Boy & 3 Girls."[12] The wide diversity in registrants points to the ability of large and small businesses to support FinCEN compliance activity. Small businesses are able to comply with FinCEN registration requirements because they can focus on preparing only one application and make relatively easier business plan adjustments to satisfy recordkeeping and reporting obligations.[13] The registration process is primarily focused on collecting initial information about the registrant and is performed electronically through a single e-filing system.[14] Ongoing compliance is not intended to be onerous; in fact, FinCEN has explicitly stated that while MSBs must establish an independent audit function to test their anti-money laundering programs, "money services businesses are not required to hire a certified public accountant or an outside consultant to conduct a review of their programs."[15] Unlike state-level money transmitter registration, FinCEN does not impose any bonding requirements, licensing fees, minimum net worth thresholds, or even background checks.[16] On the whole, federal money transmitter regulation appears reasonably well calibrated to the risk posed by payments startups.

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12 *See id*.

13 *See* 31 C.F.R. § 1010 *et seq* (2016).

14 *See* FINCEN, FINCEN REGISTRATION OF MONEY SERVICES BUSINESS (FINCEN RMSB) ELECTRONIC FILING INSTRUCTIONS 5-6 (Feb. 2013), https://www.fincen.gov/forms/files/FinCEN%20RMSB%20ElectronicFilingInstructions-%20Stand%20Alone%20doc.pdf [https://perma.cc/6G68-C7ZD] (describing each item required in registration process).

15 FINCEN, FREQUENTLY ASKED QUESTIONS CONDUCTING INDEPENDENT REVIEWS OF MONEY SERVICES BUSINESS ANTI-MONEY LAUNDERING PROGRAMS (Sept. 22, 2006), https://www.fincen.gov/statutes_regs/guidance/html/Guidance_MSB_Independent_Audits9-21.html [https://perma.cc/233S-S6JA].

16 *See* FinCEN RMSB, *supra* note 14, at 7-16.

B. In Contrast, State Money Transmitter Laws are Broad and Balkanized

At the state level, money-transmitter regulation loses its singular focus. Unlike federal regulation, state money transmitter laws are meant to promote a wide variety of sometimes conflicting policy objectives, such as growing the financial industry, consumer protection, and anti-money laundering initiatives. A review of several state statutes highlights the diverse and often overlapping range of regulatory purposes:[17]

- California regulates money transmission businesses to "protect the interests of consumers of money transmission businesses in this state, to maintain public confidence in financial institutions doing business in this state, and to preserve the health, safety, and general welfare of the people of this state."[18]
- The Texas and Illinois statutes are silent as to the purpose of regulating money transmitters,[19] but informal comments indicate a focus on consumer protection and preventing money laundering.[20]
- New York declares seven policy objectives in its Financial Services Laws, which apply to the regulation of money transmitters. Notably, the Superintendent is empowered to take action to "foster the growth of the financial industry in New York," "protect users of financial products . .

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17 States were selected based on population size, since state jurisdiction over money transmitters is usually asserted by contacts with a state's citizens. The states considered are California, Texas, Florida, New York and Illinois. Interview requests were sent to regulators in each of the five states, with one interview generously granted by money transmitter regulators from the Texas Department of Banking.

18 CAL. FIN. CODE § 2001(d) (West 2016).

19 *See* TEX. FIN. CODE ANN. § 151.002 (West 2015); *see also* 205 ILL. COMP. STAT. ANN. 657/5 (2016).

20 *See, e.g.*, *Money Services Businesses*, TEXAS DEPARTMENT OF BANKING, http://www.dob.texas.gov/money-services-businesses [https://perma.cc/2HMW-WWEE] ("The Department is responsible to protect the interests of Texas consumers who use MSBs by ensuring the overall financial condition of the MSB is sound and the MSB is properly monitoring transactions to deter money laundering, terrorist funding, or financial crimes from occurring."); *see also* 205 ILL. COMP. STAT. ANN. 657/93 (2016) (creating a fund to "provid[e] restitution to consumers who have suffered monetary loss arising out of a transaction regulated by [the Transmission of Money Act].").

. from financial impaired or insolvent providers of such services," and "eliminate financial fraud."[21]

- Florida's money transmitter regulation has traditionally been geared towards eliminating money laundering (a concern due to international drug trafficking activity in South Florida) and check-cashing businesses that operate as payday lenders.[22]

While stated policy objectives may vary, state money transmitter regulations can exhibit even greater differences. One place where states converge, however, is the expansive scope and jurisdiction asserted by state regulators. The definition of money transmission is almost unconstrained. As an example, New York prohibits "receiving money for transmission or transmitting the same" without a license.[23] There are no limitations based on transaction size or medium. Jurisdiction is also asserted broadly. State regulators typically take a greater interest if their residents are transacting with a money transmitter regardless of where it may be located. For example, California considers a person to be engaging in money transmission "in California" if her business is "physically located in California" or she is transacting "with, to, or from persons located in California."[24] States have been using this "resident" focus to ensure that out-of-state businesses are not exploiting resident customers, which in some cases ends up ensnaring unwary young startups that have a limited presence in the state.[25] However, states differ even on the resident focus. Florida defines a money transmitter as "any [entity] qualified to do business in this state" which transmits money or facilitates money transmission "within . . . or to and from *this country*"[26] (emphasis added).

State exemptions are highly variable, making it difficult for a startup to serve a nationwide market. As a preliminary matter, the states do not apply federal exemptions uniformly.

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21 N.Y. FIN. SERV. LAW § 201(b)(1)-(7) (McKinney 2016).

22 *See Regulation of Money Services Businesses, Interim Project Report 2008-101*, FLORIDA STATE SENATE COMM. ON BANKING & INS., at 1 (Nov. 2007), http://archive.flsenate.gov/data/Publications/2008/Senate/reports/interim_reports/pdf/2008-101bi.pdf [https://perma.cc/Z8XE-9R7A].

23 N.Y. BANKING LAW § 641(1) (McKinney 2016).

24 CAL. FIN. CODE § 2003(k) (West 2016).

25 *See, e.g.*, Illinois Department of Professional and Financial Regulation, *In re* TouchPay Holdings, LP., 10CC405 TouchPay Order (Jan. 7, 2013) (TouchPay was providing billpay services to Illinois inmates).

26 FLA. STAT. ANN. § 560.103(23) (2016).

FinCEN regulations identify six business activities as exempted from the definition of a money transmitter and two limitations that exempt a person from the broader definition of a money services business.[27] Of these eight exemptions, only one is consistently reflected across all states – the exemption for banks with federally insured deposits and other regulated financial institutions.[28] If the startup is not a bank, it must embark upon the difficult path of navigating exemptions and registration requirements in each state it wishes to do business. Nor does the problem end with states spurning the federal exemptions. Little overlap exists even among the five states under analysis. For example, Texas is the only state out of five that exempts armored money transports.[29] California and Texas are the only two states out of five that exempt companies providing electronic funds transfer services of governmental benefits on behalf of a public agency.[30]

Nor is standardization likely to happen anytime soon. The Uniform Money Services Act is the best hope for a unified regulatory regime. This model code was promulgated by the National Conference of Commissioners on Uniform State Laws in 2000 and outlines a standard set of licensing requirements, exemptions, and penalties to regulate an increasingly complex financial services marketplace.[31] Adoption has been slow. Since its introduction, only seven states (Alaska, Arkansas, Iowa, New Mexico, Texas, Vermont, and Washington) and two territories (Puerto Rico and the U.S. Virgin Islands) have enacted the Act.[32] This problem of inconsistent state exemptions becomes significantly more pronounced for those startups that arguably do not fit the stated regulatory intent, an issue I explore further in Section III-B.

Balkanized money transmitter regulations have thus become one of the main impediments to startup growth. While federal regulations are broad, the real pain point rests with the

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27 *See* 31 C.F.R. § 1010.100(ff)(5)(ii) & (ff)(8) (2016).

28 *See e.g.*, CAL. FIN. CODE § 2010(d) (West 2016); N.Y. BANKING LAW § 641(1) (McKinney 2016); TEX. FIN. CODE ANN. § 151.003(3), (4) (West 2015); 205 ILL. COMP. STAT. ANN. 657/15(3) (2016); FLA. STAT. ANN. § 560.104(1) (2016).

29 *See* TEX. FIN. CODE ANN. § 151.003(9) (West 2015).

30 *See, e.g.*, CAL. FIN. CODE § 2010(e) (West 2016); TEX. FIN. CODE ANN. § 151.003(6) (West 2015).

31 *See Money Services Act Summary*, UNIFORM LAW COMMISSION, http://www.uniformlaws.org/ActSummary.aspx?title=Money%20Services%20Act [https://perma.cc/LC53-SL5W].

32 *See Legislative Fact Sheet – Money Services Act*, UNIFORM LAW COMMISSION, http://www.uniformlaws.org/LegislativeFactSheet.aspx?title=Money%20Services%20Act [https://perma.cc/Y3WN-6ATJ].

legal minefield sown by the states. State regulations are a challenging trifecta of broad money transmitter definitions, expansive jurisdictional assertions, and inconsistent approaches to exemptions. This does not even include the wildly different requirements each state may impose on the same startup.[33] With access to financial services shifting to mobile platforms, startups have to be prepared to serve consumers from far-flung states and comply with a unique set of regulations in each state.

III. PAYMENTS STARTUPS ARE SHOEHORNED INTO POORLY-FITTING STATE LAWS

These fragmented and outdated laws have been drafted into service to regulate a bewildering array of payments and transaction-related startups. However, the regulatory fit between old laws and new business models is poor. In particular, startups have dramatically expanded the definition of "money" and "transmission," the two major foci of money transmitter regulation. Traditionally, a non-bank "money transmitting business" referred to Western Union and Moneygram, remitters whose sole business was to take money and send it elsewhere. Usurious check cashers that could potentially exploit consumers have been rolled into the money-transmitter or money services businesses category, especially given the emphasis many state regulators place on protecting consumers from exploitation.

But startup innovation has progressed much further than remittances and check cashers. Exhibit A illustrates the diversity of several popular payment "products," all of which involve some transfer of money from one person to another. Note that a single business may offer a multitude of payment products, some of which may qualify for a money transmission exemption and some which may not – another feature which varies by state.

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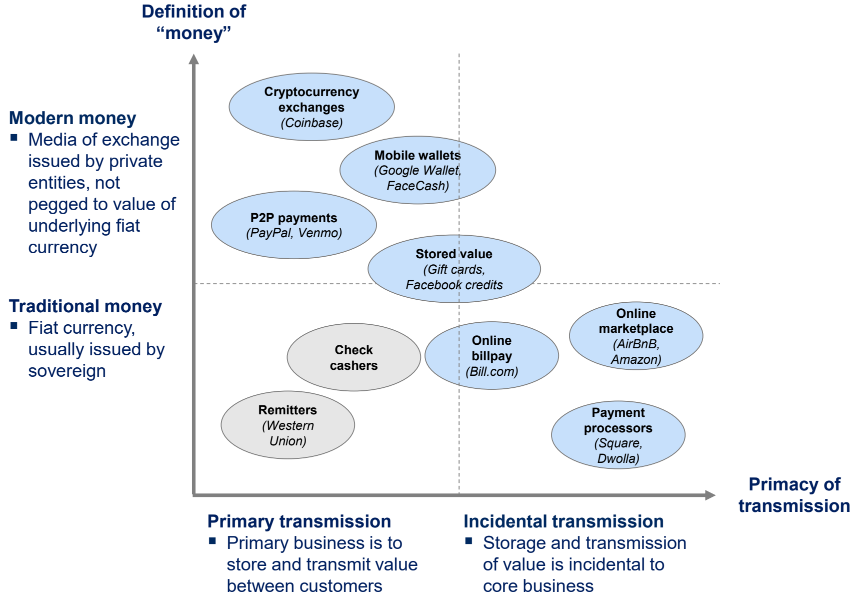
33 Two of the more onerous requirements for licensure are the maintenance of a bond and the need for audited financial statements. To highlight how different these requirements can be, New York has no limit on the security bond required, but also does not require audited financial statements. *See* N.Y. BANKING LAW § 643(1), § 641(2) (McKinney 2016). In contrast, California caps the security bond at $7,000,000 but requires audited financial statements from the applicant. *See* CAL. FIN. CODE § 2037(e), § 2032(16) (West 2016).

Exh. A: Diversification of Payments Products



One large category of payments startups focus on transmitting new forms of "money." I unimaginatively label these as "new money" startups. P2P payment providers such as PayPal and Venmo now enable individuals to directly remit money from their bank accounts or credit cards to any recipient with an account. They have taken Western Union's business model to the next level, since money can be transferred much more quickly, to a wider set of potential recipients, than the Western Union of the 20th century ever could. Mobile wallets such as Google Wallet and Apple Pay store payment options such as debit cards, credit cards, and bank accounts, helping consumers pay with their mobile devices. On the far end of modern "money," cryptocurrency exchanges such as Coinbase help customers buy and sell bitcoins, while typically providing wallet services to store purchased bitcoins. Finally, stored value instruments have also emerged as a popular financial product. These products range from the classic gift card, to more modern private currency in the form of Facebook Credits.

In addition, a whole other class of startups has emerged, where money transmission is an important feature but is incidental to the core business. These are "incidental transmission" startups. Online billpay services straddle the line between primary and incidental transmission, by helping a consumer manage and pay her bills electronically. Online marketplace platforms such as Airbnb and Etsy occupy a more clear-cut position. These platforms connect buyers and sellers of goods and services, but usually offer a native payment function to help sellers get paid. The platforms typically withdraw funds from the buyer's account and may charge the buyer or seller for use of the platform.[34] Finally, payment processors such as Square, Dwolla and Braintree build the pipes that help facilitate consumer-to-merchant payments. These startups provide easy-to-use software and hardware that allow small businesses to receive payment from consumers. The startups typically underwrite the payment to the merchant, then later withdraw the money from the consumer's bank account or charge the consumer's credit card.[35]

The variations on "money" and "transmission" show the challenges of applying old state laws to new payments businesses, even if the laws were uniform across states. Business models which expand on the definition of "money" fit better with the text and policy intent of existing regulations, while those that (inadvertently) expand on "transmission" do not fit well. Exhibit B summarizes my perspective on categorizing businesses by regulatory fit with existing money transmitter statutes. The regulatory assessment is based on two factors: the statutory text purporting to regulate money transmission, and the intent motivating such regulation.

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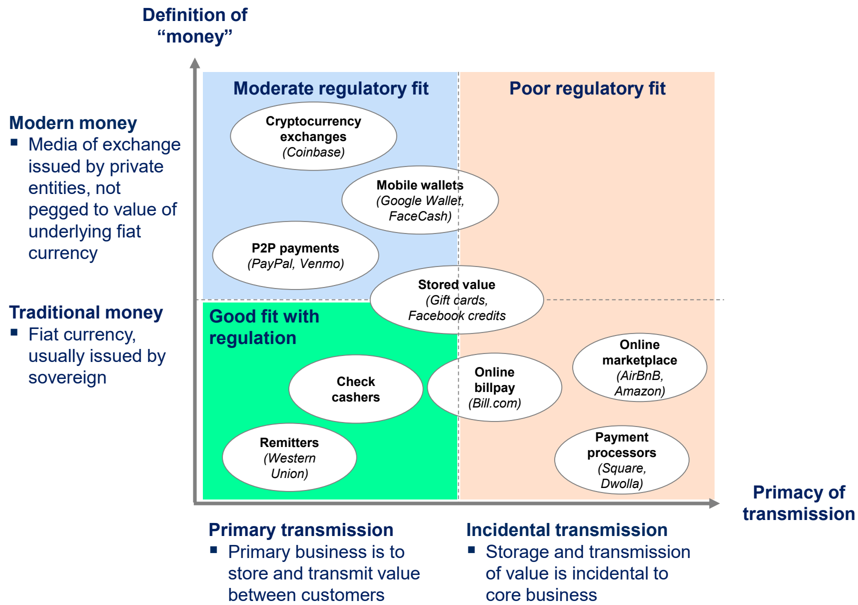
[34] *See How Airbnb Works*, AIRBNB, https://www.airbnb.com/how-it-works [https://perma.cc/T6XS-8HBS].

[35] *See About Braintree*, BRAINTREE, https://www.braintreepayments.com/about [https://perma.cc/989D-QS5S].

Exh. B: Regulatory Fit With Money Transmitter Regulation



A. New Money Startups Fit Uncomfortably With Existing Regulation

Businesses administering cryptocurrencies are a particularly useful example of new money businesses. These businesses may encompass trading in cryptocurrencies, or wallets for such currencies.[36] In assessing regulatory fit with the BSA, it appears that cryptocurrency businesses (and indeed, other virtual money administrators such as PayPal and Venmo) fall neatly within the existing statutory definitions of "money." "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 [the same] to another location or person *by any means* (emphasis added).[37] This broadly-written statute "does not differentiate between real currencies and convertible virtual currencies . . . . Accepting and transmitting anything of value that substitutes for currency makes a person a money transmitter under the regulations implementing the BSA."[38] The mere fact that the

36 *See* FinCEN, Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies, FinCEN-2013-G001 (Mar. 18, 2015), https://www.fincen.gov/statutes_regs/guidance/html/FIN-2013-G001.html [https://perma.cc/S63K-XY89].

37 *See* 31 C.F.R. § 1010.100(ff)(5)(i)(A) (2016).

38 *See* FinCEN-2013-G001, *supra* note 36.

value transmitted is not represented as physical media, nor issued by a sovereign entity, is not sufficient to exempt it from money transmission. It bears the crucial property of being valuable and substitutable for conventional currency, and that suffices to bring it under the scope of the BSA.

This also fits well with the motivating federal intent behind regulating money transmitters. The BSA was intended to "minimize[] the risk that commercial institutions might be used as money laundering vehicles."[39] Virtual currencies are particularly well suited for money laundering. Early virtual currency businesses such as E-Gold and Liberty Reserve, where a private central authority issued convertible virtual currency, were for a while "the predominant digital form of money laundering used by cyber-criminals worldwide."[40] Bitcoin ecosystems are, if anything, even more of a haven for money laundering. Bitcoins are generated through a distributed digital mining network instead of a central authority; transactions are anonymous; a range of services exist to further mask the transactional paper trail; and markets are liquid and have the potential to be associated with criminal activity.[41] It seems prudent to impose the registration, recordkeeping and retention requirements of the BSA on businesses involved in storing and transmitting bitcoins.

State-level regulation of new money startups is more problematic, due to the different statutory texts and interpretations taken. For example, the Texas Department of Banking effectively exempted Bitcoin businesses from registration. In 2014, it issued a memorandum stating that cryptocurrencies "as currently implemented cannot be considered money or monetary value under the Money Services Act," and that "absent the involvement of sovereign currency in a transaction, no money transmission can occur."[42] New York, on the other hand, took the position that while existing state money transmitter laws were insufficient, regulation was nevertheless necessary. These statutes "dated back to the civil

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39 Shawn Turner, *U.S. Anti-Money Laundering Regulations: An Economic Approach to Cyberlaundering*, 54 CASE WESTERN RES. L. REV. 1389, 1402 (2004).

40 Sarah Gruber, *Trust, Identity and Disclosure: Are Bitcoin Exchanges The Next Virtual Havens For Money Laundering And Tax Evasion?*, 32 QUINNIPIAC L. REV. 135, 173-74 (2013).

41 *See id.* at 176-77 (discussing money-laundering risks associated with Bitcoin).

42 *Regulatory Treatment of Virtual Currencies Under the Texas Money Services Act, Supervisory Memorandum 1037*, TEXAS DEPARTMENT OF BANKING 3 (Apr. 3, 2014), http://www.dob.texas.gov/public/uploads/files/consumer-information/sm1037.pdf [https://perma.cc/Z3A2-MT6J].

war – when there was barely mass communication, let alone an Internet."[43] The New York Department of Financial Services thus proposed and implemented BitLicense, a new regulatory framework for registering and regulating virtual currency businesses.[44] Thus, there is considerable disagreement among states on the threshold question of whether to even regulate new money businesses.

The thorny question of *how* to regulate them may cause even more confusion and potential for regulatory arbitrage. New York and California, for example, are both trying to regulate Bitcoin. New York's BitLicense regulatory framework defines "virtual currency business activity" as "storing, holding, or maintaining custody or control of virtual currency on behalf of others" and "controlling, administering, or issuing a virtual currency."[45] The regulation drew ire from New York virtual currency businesses, with several startups blocking New York IP addresses or leaving New York entirely.[46] California took a narrower approach in AB 1326 by defining a "virtual currency business" as one that maintains "full custody or control of virtual currency in [California] on behalf of others."[47] The difference in control would have created potentially very different treatment of entities that share partial control of virtual currencies, such as multi-sig wallets where approval from a majority of independent authorized entities are required to execute a transaction.[48] AB 1326 also intentionally exempted software providers and required fewer licenses than New York, with the Bill's sponsor claiming "AB 1326 really creates the opportunity for California to become the next stop for virtual currency companies looking to leave New York."[49] California

43 Benjamin Lawsky, Superintendent, New York Department of Financial Services, Remarks at the BITS Emerging Payments Forum (June 3, 2015), http://media.scmagazine.com/documents/127/speech_-_june_3,_2015__nydfs_a_31558.pdf [https://perma.cc/G28Z-7LVK].

44 *See* N.Y. COMP. CODES R. & REGS. tit. 23, § 200 *et seq.* (2016).

45 N.Y. COMP. CODES R. & REGS. tit. 23, § 200.2(q)(2)-(5) (2016).

46 *See* Yessi Bello Perez, *The Real Cost of Applying for a New York BitLicense*, COINDESK, (Aug. 13, 2015), http:// www.coindesk.com/real-cost-applying-new-york-bitlicense [https://perma.cc/PCE9-KH8K].

47 Assembly Bill 1326, Virtual Currency, § 3, 2015-2016 Reg. Sess. (Cal. 2015), https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201520160AB1326 [https://perma.cc/C67B-ZDUP].

48 *See generally* Ben Davenport, *What is Multi-Sig, and What Can It Do: A Backgrounder for Policymakers*, COIN CENTER (Jan. 1, 2015), https://coincenter.org/2015/01/multi-sig [https://perma.cc/6SP7-PYNH].

49 Press Release, *Assemblymember Dababneh Responds to Electronic Frontier Foundation Attacks on the Virtual Currency Act - AB 1326*, ASSEMBLYMEMBER MATTHEW DABABNEH DISTRICT 45 (Aug. 13, 2015), http://asmdc.org/members/a45/news-room/press-releases/assemblymember-

will surely not be the only state trying to pick up startups fleeing more restrictive jurisdictions, and startups certainly do not shy away from fighting regulation. AB 1326 died in the California Legislature following intense opposition from advocacy groups such as the Electronic Frontier Foundation, which argued that regulation was premature since "digital currency is an industry in its infancy."[50]

Wholesale resistance to regulation of new money startups is unjustified. Given the large sums of consumer money and complex payments flows involved, consumers deserve some form of regulatory protection. Furthermore, better-tailored regulation would likely be an improvement over shoehorning all participants in virtual currency, P2P payments, and mobile wallets into existing money transmitter laws.[51] The central problem with new money regulation lies not in the breadth of scope but in the diversity of approach. When a new business faces licensure in New York, no licensure in Texas, and confusion in California, it is unable to appropriately plan for growth and capital-raising activities. A fragmented approach will likely also hurt consumers in the long run, as states vie to provide more generous exemptions for ever-growing new money businesses. I explore these topics in greater detail in Section IV.

B. Incidental Transmission Startups Are Not Meant to Fall Under Existing Regulation

Incidental transmission businesses are in a different position from new money businesses. Unlike new money businesses, these companies are engaged in core activity that stands far outside the original intent of money transmitter regulation. Yet due to the broad interpretation of money transmission, facilitation of payments made to support the core

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dababneh-responds-to-electronic-frontier-foundation-attacks-on-the-virtual-currency-act-ab-1326 [https://perma.cc/UR9E-W4PF].

50 Rainey Reitman, *A License to Kill Innovation: Why A.B. 1326—California's Bitcoin License—is Bad for Business, Innovation, and Privacy*, ELECTRONIC FRONTIER FOUNDATION (Aug. 7, 2015), https://www.eff.org/deeplinks/2015/08/license-kill-innovation-why-ab-1326-californias-bitcoin-license-bad-business [https://perma.cc/29PZ-L5A6].

51 *See* Kery Murakami, *Bitcoin Advocates Split Over California Bill*, BLOOMBERG BNA (Aug. 17, 2015), http://www.bna.com/bitcoin-advocates-split-n17179934796 [https://perma.cc/8YET-VPDA] (Proponents of AB 1326 argued that if the bill failed, virtual currency startups would be required to hold securities equal to the total amount of virtual currency secured.).

business activity may rope them into the scope of money transmitter regulation. Whether they are indeed money transmitters depends on widely-varying exemptions, and thus they are even more affected by state law variation than new money businesses.

Federal regulations fortunately exempt many of these businesses from MSB registration, by way of the payment processor exemption.[52] Three popular business models often implicate money transmission incidental to the core business activity. First, payment processors like Square and Dwolla provide access to ACH and credit card network infrastructure to enable transactions between payers and payees.[53] Second, some online marketplaces such as Flipkart and Airbnb accept payment from buyers on behalf of sellers, taking possession and control of the sender's money to be transferred to the merchant recipient some time later. Finally, billpay aggregators like Prism help customers manage multiple bills and pay them down more efficiently.

Payment processors are directly exempted under FinCEN's payment processor exemption, as long as the activity meets four conditions: a) the entity providing the service must facilitate the purchase of goods and services, or the payment of bills for goods and services; b) the entity must operate through clearance and settlement systems that admit only BSA-admitted financial institutions; c) the entity must provide the service pursuant to a formal agreement; and d) the entity's agreement must be at a minimum with the seller or creditor that provided the goods and services and receives the funds.[54] The payment processor exemption also extends to online marketplaces, under a FinCEN legal opinion holding that "[this type of funds transfer] . . . more closely resembles payment

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52 *See* 31 C.F.R. § 1010.100(ff)(5)(ii)(B) (2016).

53 *See* Sarah Kessler, *How Dwolla Works*, FAST COMPANY (Oct. 2, 2012), http://www.fastcompany.com/3001833/how-dwolla-works [https://perma.cc/7P7M-QHGM] (Dwolla and Square offer a variety of payment products. An example of a core Dwolla product is the ability to "transfer money directly from your bank account to the bank account of someone who you want to pay." The funds pass through Dwolla's accounts, which today "are held in pooled accounts at Veridian Credit Union and Compass Bank."); *see also* DWOLLA, https://www.dwolla.com/about [https://perma.cc/XT7C-U3XH].

54 *See* FINCEN, APPLICATION OF MONEY SERVICES BUSINESS REGULATIONS TO A COMPANY ACTING AS AN INDEPENDENT SALES ORGANIZATION AND PAYMENT PROCESSOR, FIN-2014-R009 (Aug. 27, 2014), https://www.fincen.gov/news_room/rp/rulings/html/FIN-2014-R009.html [https://perma.cc/B59W-QJE3].

processing/settlement than money transmission."[55] Even billpay aggregators qualify as payment processors. FinCEN held that billpay aggregators which "[accept] payments only on behalf of the [billers] with whom it has contracted as an agent, and declines to accept and transmit funds for any other purpose [will not be deemed a money transmitter]."[56] The expansive nature of the payment processor exemption evinces FinCEN's approach to money services businesses. If the transferred funds are flowing over currently-regulated clearing and settlement networks and the business is acting as an agent of the payee, no registration is needed since both the anti-money laundering and consumer protection concerns have been addressed.

At the state level, incidental transmission businesses face an impenetrable regulatory thicket. Payment processors, online marketplaces and billpay aggregators do not fit well with the original legislative vision. Most states have anti-money laundering and financial safety-and-soundness goals, as well as consumer protection mandates.[57] But transactions facilitated by incidental transmission businesses often avoid implicating those concerns, even though they "transmit money" as defined by state statute. For example, payment processors and online marketplaces are often moving funds between BSA-approved institutions over well-regulated clearing and settlement networks, arguably mitigating anti-money laundering and safety-and-soundness concerns. Thus, they enjoy a federal payment processor exemption. Unfortunately, that exemption is not universally available, resulting in such businesses being shoehorned into registration requirements. To point to another example, many online marketplaces and billpay aggregators explicitly assume the consumer's obligation of paying creditors or merchants once they have received consumer funds. This should decrease the risk of consumers being left hung out to dry, should the money transmitter become insolvent or abscond with the funds. Yet many states do not offer exemptions to businesses who act as agents for the

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55 FINCEN, FINCEN RULING 2003-8 – DEFINITION OF A MONEY TRANSMITTER (MERCHANT PAYMENT PROCESSOR) (Nov. 19, 2003), https://www.fincen.gov/news_room/rp/rulings/html/fincenruling2003-8.html [https://perma.cc/5ZDK-6TQL].

56 FINCEN, WHETHER AN AUTHORIZED AGENT FOR THE RECEIPT OF UTILITY PAYMENTS IS A MONEY TRANSMITTER, FIN-2008-R006 (May 21, 2008), https://www.fincen.gov/statutes_regs/guidance/html/fin-2008-r006.html [https://perma.cc/7UWX-YKAV].

57 *See infra* Section II-B.

payees, instead choosing to regulate these businesses as they would a traditional money transmitter which assumes no obligations upon receipt of funds.

The above examples illustrate the key problem with state-level regulation of incidental transmission businesses. These businesses are uniformly captured by broad money transmitter definitions, but haphazardly excluded based on particular state exemptions - despite possessing transactional features that address the purpose of such regulation. The inconsistent availability of two particular exemptions is particularly challenging. While many of the exemptions are narrow (e.g., transmitting government benefits, or providing real estate escrow services), the agent-of-the-payee and authorized delegate exemptions are meant to exempt businesses that adequately mitigate stated legislative concerns. The agent-of-the-payee exemption exempts "transaction[s] in which the recipient of the money or other monetary value is an agent of the payee pursuant to a preexisting written contract and delivery of the money or other monetary value to the agent satisfies the payor's obligation to the payee."[58] The authorized delegate exemption exempts "a person that acts as an intermediary on behalf of and at the direction of a license holder . . . provided that the license holder is liable for satisfying the obligation owed to the purchaser."[59] The former addresses consumer protection concerns by assuming the sender-consumer's obligations to the merchant-recipient; the latter addresses money-laundering and safety-and-soundness concerns by forcing well-regulated licenseholders to take responsibility for their delegates or sublicensees. These exemptions are important for two reasons. First, they exempt businesses that do not implicate regulatory priorities. Second, and more importantly, they allow incidental transmission businesses to address regulatory concerns without fundamentally changing their core business model. Incidental transmission businesses with access to these exemptions can agree to assume consumer obligations, or can be supervised by licenseholders under stringent conditions as an authorized delegate. The exemptions offer an attractive path between illegal money transmission and burdensome registration for a non-core business activity.

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58 CAL. FIN. CODE § 2010(l) (West 2016); *see also* N.Y. BANKING LAW § 641(1) (McKinney 2016).

59 TEX. FIN. CODE ANN. § 151.003(7) (West 2015); *see also* N.Y. BANKING LAW § 641(1) (McKinney 2016).

It is thus particularly challenging when states differ markedly in offering these exemptions. Illinois and Florida do not appear to have any agent-of-the-payee exemptions. Texas does not have a statutory agent-of-the-payee exemption, but instead has a similar common law exemption requiring agents to demonstrate actual authority expressly, granted, through written contracts.[60] New York and California offer the agent-of-the-payee exemption by statute, though California's exemption was only introduced in 2014. Under the California Money Transmission Act of 2010, no agent-of-the-payee exemption existed, and online marketplace businesses such as Airbnb were considered money transmitters by the Department of Financial Institutions.[61] California finally passed several amendments adding a limited agent-of-a-payee exemption in 2014.[62] The authorized delegate exemption fares no better. It appears to be available in Texas and New York, but not available in the other three largest states.[63] To complicate things further, states are proposing different interpretations of what an authorized delegate is permitted to do. Some states are variously imposing in-state physical presence requirements (presumably to avoid rent-a-license activity), or limiting the type of business activity permitted to specific payment products.[64] Texas has provided clear criteria for when an

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60 *See A Person Providing Bill Payment Services as An Agent of the Payee Is Not Engaged in the Business of Money Transmission and Does Not Need A License Under the Texas Money Services Act*, Law and Guidance Manual Opinion No. 14-01, TEXAS DEPARTMENT OF BANKING (May 9, 2014), http://z2policy.ctspublish.com/texas/Z2Browser2.html?showset=txdobset&collection=texas&documentid=512 [https://perma.cc/HM69-3XHW].

61 *See* Owen Thomas, *This Innovation-Killing California Law Could Get a Host of Startups in Money Trouble*, BUSINESS INSIDER (July 11, 2012), http://www.businessinsider.com/california-money-transmitter-act-startups-2012-7 [https://perma.cc/MXP2-97U9]. Airbnb ended up registering as a money transmitter despite arguing that it did not qualify as one. *See Directory of Money Transmitters*, CALIFORNIA DEPARTMENT OF BUSINESS OVERSIGHT, http://www.dbo.ca.gov/Licensees/money_transmitters/money_transmitters_directory.asp [https://perma.cc/NLL8-ZACR] (listing Airbnb Payments as a license holder).

62 *See* Assembly Bill 2209: Money Transmission Act §3(*l*), 2013-2014 Reg. Sess. (Cal. 2014), https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201320140AB2209 [https://perma.cc/U4YE-5ZQJ].

63 *See* Texas and New York statutes, *supra* note 59.

64 *See* Judith Rinearson *et al.*, *The Latest in Money Transmitter Licensing*, BRYAN CAVE LLP 18 (Feb. 19, 2015), http://root.bryancavemedia.com/docs/money-transmitter-webinar.pdf [https://perma.cc/QRX3-SDHJ].

authorized delegate relationship exists,[65] but states are only now beginning to adopt this reasoning. The availability of these crucial exemptions will likely continue to be scattered.

The capacious nature of the money transmitter definition and the inconsistent availability and approach of two key exemptions often force incidental transmission startups into difficult positions. I explore the costs and benefits of imposing these highly variable state money transmitter regulations on new money and incidental transmission businesses alike in the following section.

IV. FRAGMENTED STATE MONEY TRANSMITTER STATUTES HARM CONSUMERS

The poor fit between state laws and payments startups (both new money and incidental transmission) imposes significant costs on startups and consumers. Early-stage startups are faced with a difficult choice when deciding how to comply with money transmitter laws: proactively seek licensure in all relevant jurisdictions, or fly under the radar until they get large enough to apply for licenses. The requirement of individual state licensure can kill a startup early in its life, depriving consumers of beneficial innovation in return for few additional protections. These protections are certainly valuable – for example, states typically require surety bonds to ensure consumers are reimbursed in case the business fails and loses customer money. However, multiple overlapping and conflicting licensing requirements are unlikely to add much to overall consumer protection. This section compares the high cost of multi-state regulation against the modest benefits of complying with varying licensure requirements in each state.

A. Payments Startups Face Fatal Regulation Early in Their Lives

The cost of registering in all states is high. A recent 50-state survey of money transmitter licensing requirements highlights the near-impossibility of nationwide registration for

[65] *See Appointment of an Authorized Delegate to Conduct Money Transmission on Behalf of a License Holder*, Supervisory Memorandum 1038, TEXAS DEPARTMENT OF BANKING (Oct. 13, 2014), http://www.dob.texas.gov/public/uploads/files/Laws-Regulations/New-Actions/sm1038.pdf [https://perma.cc/H2UB-EG5R].

an early-stage startup.[66] States typically require extensive business plan documentation, audited financial statements, and founder background checks. Many states also have a minimum net worth requirement, which would impede licensure for new startups. Yet these requirements pale in comparison to the capital cost of licensure – the surety bond requirement. Getting licensed in the five most populous states (California, Texas, Florida, New York, and Illinois) would require a minimum of $1.2 million in surety bonds posted with the relevant state financial regulator.[67] The bonds further require an annual maintenance cost, which some have put between 2% and 7%.[68] Assuming that a young business is able to muster the surety bonds needed in each state, some estimates place the upfront cost of nationwide licensure at nearly $180,000, with an annual maintenance cost of about $140,000. For context, seed-stage startups raised, on average, just over $1,000,000 in seed financing in 2014.[69] A nationwide licensing program could cost up to one-third of the startup's available funds. Even worse, this figure simply covers application and financing costs, and does not include legal fees and any other professional fees needed to meet licensing requirements, such as developing an AML program or auditing financial statements.

FaceCash is a particularly colorful example of how difficult it can be to get licensed, even with the best intentions. FaceCash was a California payments business launched in 2010, allowing users to transfer funds into a digital wallet and use these funds at select retailers. The user could pay by opening the FaceCash mobile app and displaying a barcode. The retailer would scan the code, check the user's photograph

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66 *See* Thomas Brown, *50-State Survey: Money Transmitting Licensing Requirements*, PAUL HASTINGS LLP (2013), http://abnk.assembly.ca.gov/sites/abnk.assembly.ca.gov/files/50%20State%20 Survey%20-%20MTL%20Licensing%20Requirements(72986803_4).pdf [https://perma.cc/2K35-2HFH].

67 Minimum surety bonding requirements: California – $250,000; Texas – $300,000; Florida – $50,000; New York – $500,000; and Illinois – $100,000. *See id.* for full details on licensure requirements by state.

68 *See* Allen Scott, *How to Protect Your Bitcoin Business from Regulators*, COINTELEGRAPH (Oct. 30, 2014), http://cointelegraph.com/news/112826/how-to-protect-your-bitcoin-business-from-regulators [https://perma.cc/LU9V-XJTC].

69 *See* Danielle Morrill, *Why Is the Number of Seed Rounds Raised in 2014 Down 30%? Exploring the Connection Between Startup Funding Activity and U.S. Interest Rates*, MATTERMARK (Jan. 16, 2015), https://mattermark.com/exploring-the-connection-between-startup-funding-activity-and-u-s-interest-rates [https://perma.cc/5EEB-3T5U].

(hence, FaceCash) and complete the transaction.[70] In September 2010, California passed its Money Transmission Act, which added domestic money transmission to its covered activities.[71] FaceCash decided to proactively apply for a license, but soon ran into difficulties. According to FaceCash, "the DFI [was] unwilling to provide a single number explaining how much money is actually required to obtain a license." In the face of this regulatory uncertainty, the startup could not apply for a license since "if the California DFI were to deny our application for a license, we would be at risk of being denied licenses in every other state in which we apply. Each state's license application asks whether the applicant has been denied any other kind of license for any reason."[72] FaceCash could face stiff civil and criminal penalties for violating the MTA. It lacked the resources to survive an ambiguous registration process or mount a lobbying challenge, and went shortly out of business thereafter.[73]

Flying under the radar is thus a common alternative, on the assumption that smaller operations are less likely to attract regulatory scrutiny. In this model, startups commence money-transmitting operations in a state but only apply for the requisite license when they have the resources to do so. For resource-constrained startups, this may be the only viable choice that keeps them in business. The "begging forgiveness instead of asking permission" approach has (in)famously worked for some now-successful businesses. For example, PayPal refused to get licenses early on, but finally caved in after coming under pressure from a multi-state alliance of regulators.[74] Square operated without the full set of required money transmitter licenses since 2009, but was hit with its

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70 *See* Evelyn Rusli, *From "Face Book" to FaceCash: How Aaron Greenspan Is Tackling Mobile Payments*, TECHCRUNCH (Aug. 3, 2010), http://techcrunch.com/2010/08/03/facebook-facecash-aaron-greenspan-mobile-payments [https://perma.cc/57HC-BW2P].

71 *See* CAL. FIN. CODE § 2000(d) ("[I]t is necessary to regulate money transmission businesses in this state.").

72 *Information for California Residents*, FACECASH (Nov. 14, 2011), https://www.facecash.com/legal/ca.html [https://perma.cc/S837-9BA2].

73 For a full account of FaceCash's challenges, *see* Sean Sposito, *How California Law Put a Hot Payments Innovator on Ice*, AMERICAN BANKER (Aug. 6. 2013), http://www.americanbanker.com/issues/178_151/how-california-law-put-a-hot-payments-innovator-on-ice-1061147-1.html?zkPrintable=1&nopagination=1 [https://perma.cc/C7FW-HDY5].

74 Tim Fernholz, *The Patchwork Of Regulations Entangling Square, And Every American Internet Startup That Takes Money*, QUARTZ (Mar. 14, 2013), http://qz.com/62265/why-square-and-seven-other-finance-start-ups-got-run-out-of-illinois [https://perma.cc/F5AP-EEQU].

first cease-and-desist order only in 2013 by Illinois regulators.[75] Square also had to pay a $507,000 fine to Florida's regulators, who quickly followed in Illinois' footsteps.[76] However, the enforcement actions and fines were no longer fatal – Square had gotten large enough to lobby against the actions and even pay fines if they became unavoidable.

The risks of this strategy are obvious. First, transmitting money without a license can be a felony in some states,[77] although regulators often content themselves with cease-and-desist letters and fines. More importantly, state regulators are sophisticated and on the lookout for potential unlicensed money transmission activity. While state money transmitter departments are often resource-constrained, regulators have indicated that they pay close attention to customer complaints and competitor concerns to identify unlicensed activities. Regulators also frequently share information on enforcement activity across states, and in some cases, proactively scan startup news websites such as TechCrunch for business models that constitute money transmission.[78] Finally, this strategy hinges on getting large enough in a short period of time to survive regulatory scrutiny. Startups that take longer to mature, or that happen to be caught earlier in their lifecycle, are out of luck.

It is hard to know how many startups are engaged in evasion. However, a quick analysis of enforcement orders reveals that surprisingly few startups fold when discovered, which may tip the risk-reward calculation towards evasion. Illinois, for example, issued cease-and-desist orders in January 2013 against five money transmitters. The businesses included both traditional money transmitters such as Skrill (online low cost money transfers), to incidental transmission businesses

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75 *See* In the Matter of Square, Inc., Illinois Department of Professional and Financial Services, No. 13 CC 208 (Jan. 22 2013). The cease-and-desist was eventually withdrawn in 2015 as part of a policy revision towards third-party processors; Press Release, *Third-Party Payment Processors No Longer Require Money Transmitter Licensure in Illinois*, ILLINOIS DEPARTMENT OF PROFESSIONAL AND FINANCIAL SERVICES (July 29, 2015), http://www.idfpr.com/News/newsrls/ThirdPartyProcessorNotice07292015.asp [https://perma.cc/PXT3-CLMJ].

76 *See In re Square, Inc.*, State of Florida Office of Financial Regulation, No. 0321-MR-07/13 (July 24, 2013).

77 *See* N.Y. BANKING LAW § 650(b) (McKinney 2016) (knowingly engaging in money transmission without a license is a Class E felony).

78 Phone telephone interview with Russell Reese, Director of Special Audits, Deborah Loomis, Deputy General Counsel, and Brenna McGee, Assistant General Counsel, Texas Department of Banking (Feb. 18, 2016) (notes on file with author).

such as TouchPay and Netspend (billpay aggregators) and Square (a payments processor).[79] Only one target seems to have ceased doing business – Pelican Personified, which apparently helped immigrants send money back to India, no longer has an active website. The orders uniformly required the businesses to cease and desist their activities and produce accounts of money transferred on behalf of Illinois consumers. These businesses were also liable for the total of (1) $1,000 per violation, (2) $1,000 for each day they were in violation of Illinois' Transmitters of Money Act, and (3) up to four times the amount of unlicensed money transmitted.[80] The high survival rate may indicate that discovery tends to happen late enough that the businesses can afford to cure and comply.

B. Consumers Lose Access to Beneficial Innovation But Gain Little in Return

For many startups, the risk of breaking the law is too high. Some are lucky enough to have a transaction structure flexible enough to avoid the imposition of money transmitter laws. For example, funds transfers can be outsourced to back-end payment processors to avoid falling afoul of money transmitter laws. TaskRabbit, a site that matches workers with small jobs, collects money from users and pays workers on its platform. It avoids taking possession and control of customer funds by contracting Braintree to handle the payments workflows.[81] However, if a suitable partner cannot be found or if control of the payments is integral to the business model, startups face two options – terminate the venture (as FaceCash did) or terminate services in states with tougher regulation. As discussed above, there appear to be relatively few examples of startups closing their doors as a direct consequence of money transmitter regulation. Extrapolating from the FaceCash example, some number of innovations never get off the ground because of the high initial investment needed for licensure. Payments experts have observed that this

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79 *See Financial Institutions Disciplinary Actions*, ILLINOIS DEPARTMENT OF PROFESSIONAL AND FINANCIAL REGULATION (May 10, 2016), https://www.idfpr.com/dfi/ccd/tomadiscipline.asp [https://perma.cc/YK4W-Q83L].

80 *See* Touchpay Order, *supra* note 25, at 3.

81 *See* John Tozzi, *TaskRabbit Doesn't Want the Headache of Handling Your Money*, BLOOMBERG BUSINESSWEEK (Aug. 14, 2013), http://www.bloomberg.com/bw/articles/2013-08-14/taskrabbit-doesnt-want-the-headache-of-handling-your-money [https://perma.cc/7YXE-AUXG].

effectively sets up a barrier to entry, since only large and successful businesses can afford to apply for licensure in all relevant states.[82]

More often, payments choose to restrict access to consumers in states with onerous laws. New York saw this scenario unfold when it implemented BitLicense, the licensing framework for Bitcoin businesses. When the deadline arrived in August 2015, at least ten Bitcoin startups cut off service to New York State customers, and some even moved physically out of state.[83] One Bitcoin exchange highlighted the cost-benefit trade-off involved, stating "the license comes at a price that exceeds the market opportunity of servicing New York residents. Therefore, we have no option but to withdraw our service from the state."[84] In contrast, Bitcoin has an "unusually heavy presence in Texas," driven by support from legislators and an increasing number of businesses accepting it as payment.[85] Certainly the Department of Banking's Supervisory Memorandum 1037, holding that bitcoins are not currency and thus not subject to regulation, was a contributing factor.[86] Thus, the main harm involved would appear to be depriving consumers of payments innovation that could be cheaper, faster or more secure.

"Assessing and quantifying the benefits of financial innovation is widely recognized as being almost impossible due to the distinct characteristics of financial innovation."[87] The literature thus focuses on qualitative benefits, such as greater financial inclusion, more comprehensive insurance, or cheaper credit.[88] For this particular group of payments innovation, much of the benefit to consumers is likely to be increased transaction convenience and lower transaction costs. New money startups like Venmo and Coinbase allow customers to transfer value with a single click, avoiding the hassle of

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82 *See* Fernholz, *supra* note 74.

83 *See* Daniel Roberts, *Behind the "Exodus" Of Bitcoin Startups From New York*, FORTUNE (Aug. 14, 2015) http://fortune.com/2015/08/14/bitcoin-startups-leave-new-york-bitlicense [https://perma.cc/9QXS-KB5K].

84 *Id.*

85 Loren Steffy, *Start Making Cents*, TEXAS MONTHLY (Aug. 2014), http://www.texasmonthly.com/politics/start-making-cents [https://perma.cc/3PY7-DML9].

86 *See* Supervisory Memorandum 1037, *supra* note 42, at 3.

87 World Economic Forum & Oliver Wyman, *Rethinking Financial Innovation: Reducing Negative Outcomes While Retaining the Benefits*, WORLD ECONOMIC FORUM 19 (2012), http://www3.weforum.org/docs/WEF_FS_RethinkingFinancialInnovation_Report_2012.pdf [https://perma.cc/Y8F3-QH85].

88 *See id.*

initiating bank transfers with large amounts of paperwork. Furthermore, the transfers are usually much less costly than traditional payment transfer systems – Venmo and Coinbase both provide transfer services free of charge, versus paying ACH or wire transfer fees at the user's bank.

Incidental transmission startups offer these benefits and more. The core innovation can be extremely valuable and popular. Online marketplaces have revolutionized shopping. E-commerce has grown steadily from 2.8% of total retail sales in 2006 to 7.6% of the same in 2015.[89] The sharing economy, represented by companies such as Airbnb and Uber which help users share their property for profit, is sized at $15 billion today but will reach $335 billion by 2025.[90] Bringing down the hammer of money transmitter regulation could inconvenience millions of users, either through cessation of service as marketplaces avoid offering services in that state, or through greater pass-through costs as marketplaces contract out basic payments services to companies that already have the appropriate license portfolio. Payment processors create significant consumer benefits by enabling faster, more efficient transactions that are not executed in physical cash. Dwolla and Braintree help small merchants accept and process payments from customers, enabling many small businesses to participate in online sales at a much lower cost (compared to setting up a traditional credit card terminal). Finally, billpay aggregators help consumers manage and pay bills on time, using the most convenient means of payment available to them. Prism, for example, connects with all of a customer's billers and notifies them when it discovers a new bill, thereby helping them avoid late fees and missed payments.[91] Plastiq is another flavor of the billpay aggregator model, allowing customers to pay any bill with their credit cards for a fee.[92] Both these business models

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89 *See* U.S. Department of Commerce, *Quarterly Retail E-Commerce Sales: 3rd Quarter 2015*, U.S. CENSUS BUREAU NEWS (May 17, 2016), https://www.census.gov/retail/mrts/www/data/pdf/ec_current.pdf [https://perma.cc/5C9G-2P57].

90 *See* Press Release, *Five Key Sharing Economy Sectors Could Generate £9 Billion Of UK Revenues By 2025*, PRICEWATERHOUSECOOPERS PRESS ROOM (Aug. 15, 2014), http://pwc.blogs.com/press_room/2014/08/five-key-sharing-economy-sectors-could-generate-9-billion-of-uk-revenues-by-2025.html [https://perma.cc/JL68-4SHA].

91 *See Introducing Prism: Prism is a Free App that Helps you get Control of your Money*, PRISM, https://www.prismmoney.com/about [https://perma.cc/Z55X-6CRC].

92 *See* PLASTIQ, https://www.plastiq.com [https://perma.cc/QZ4V-SHM2].

offer consumers more control over their payments, leading to greater convenience and savings.

The heavy burden of regulation costs consumers their access to these innovations when a startup terminates service in a state, or even worse, never gets off the ground. However, this is only one side of the cost-benefit equation. Most state money transmitter laws aim to protect consumers from being exploited or defrauded. The registration and recordkeeping requirements ensure that unqualified transmitters do not enter the system, and the bonding requirement helps make consumers whole if the money transmitter becomes insolvent. Consumer advocate groups have noted that while they have received few complaints about "not being able to get money at all or having transactions not go through," the law exists to prevent or reduce the incidence of bad actors in the market.[93] Subjecting all payments businesses to state money transmitter law yields only modest benefits, and the incremental benefits of requiring redundant registration in every state are even slimmer.

The new money versus incidental transmission distinction is particularly pertinent when evaluating the benefits of any given state's regulation. New money businesses should certainly be subject to additional regulation beyond FinCEN registration. These businesses implicate many, if not more, of the same risks as a traditional money transmitter like Western Union. As described earlier, these businesses have previously been a haven for money launderers. Stored value instruments, another modern form of private money, have also come under scrutiny for exposing consumers to "risks greater than those associated with the more conventional credit and debit cards commonly used by middle- and upper-class consumers."[94] The consumer has to dedicate funds to the card or modern day equivalent (e.g., buying credits for a Facebook account) in advance of the purchase transaction. This directly exposes the consumer to the risk of issuer insolvency. Additionally, consumers run the risk of having unused funds returning to either the issuer or the state via dormancy fees and escheat rules.[95] Cryptocurrency businesses are certainly

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93 Marc Lifsher & Jessica Guynn, *Silicon Valley Start-ups Decry State Money Transmission Law*, L.A. TIMES (Apr. 2, 2013), http://articles.latimes.com/2013/apr/02/business/la-fi-mobile-money-20130402/2 [https://perma.cc/TZ7J-GLDP].

94 Liran Haim & Ronald Mann, *Putting Stored-Value Cards in Their Place*, 18 LEWIS & CLARK L. REV. 989, 1009 (2014).

95 *See id.* at 1013-14.

the most deserving of regulation. The untraceability and anonymity of bitcoins makes theft incredibly easy, especially if consumers are trusting enough to leave them in wallets under control of an unregulated third party. Illegal darknet markets, such as the now-defunct Silk Road, are a prime example of such risks. Users (who typically use these markets to purchase illicit goods and services) have fallen afoul of multiple "exit scams" in which market administrators loot the stored bitcoins and flee.[96] Thus, while new money businesses certainly bring efficiency and cost benefits to their users, they carry many, if not all, of the classic risks posed by traditional money transmitters and should therefore be regulated.

In contrast, blanket regulation of incidental transmission businesses as money transmitters is a clumsy way of protecting consumers. Regulators are understandably concerned with companies taking possession and control of large sums of consumer money, even if solely for the purpose of paying legitimate creditors. If the company were to become insolvent (or abscond) while holding consumer funds, the motivation for transmittal becomes irrelevant – functionally, it acted as a money transmitter. In a less extreme scenario, improper handling of consumer funds could pose a threat to consumer financial protection. Airbnb for example, was late to send payouts to hosts all over the world in September 2015, prompting serious concerns from hosts when they failed to receive a consistent answer for the delays.[97] However, some states have paved the way for meeting consumer protection goals while being judicious about which businesses actually require licensure. Texas, for example, offers an agent-of-the payee exemption if the transmitter has a written contract of agency on behalf of the creditor.[98] In conversations with the Department of Banking, regulators have further emphasized their willingness to consider factors such as whether customer funds are held separate from operating funds, or how long the funds stay within possession and control of the company.[99]

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[96] *See* Jon Christian, *The 'Exit Scam' is the Darknet's Perfect Crime*, MOTHERBOARD (Feb. 4, 2015), http://motherboard.vice.com/read/darknet-slang-watch-exit-scam [https://perma.cc/8F4E-CAAG].

[97] *See* Ellen Killoran, *Airbnb Keeping Hosts in the Dark about Missing Payments*, FORBES (Sept. 15, 2015), http://www.forbes.com/sites/ellenkilloran/2015/09/15/airbnb-keeping-hosts-in-the-dark-about-missing-payments/#2f6a22a469e6 [https://perma.cc/P7SL-NKRS].

[98] *See* Law and Guidance Manual Opinion No. 14-01, *supra* note 60.

[99] *See* Interview with Russell Reese, Deborah Loomis, and Brenna McGee, *supra* note 78.

Texas leaves some exemption discretion to its commissioner,[100] and could be a valuable example of judicious regulation that does not deprive consumers of protection.

If there is little unique benefit to regulating incidental transmission at the state level, there is even less benefit from having multiple states impose wildly different licensure and reporting standards. The same is true for regulation of new money. The first key problem is that compliance costs are not necessarily related to the startup's level of exposure in a particular state. For example, New York requires a minimum surety bond of $500,000, while Florida imposes a minimum of $50,000.[101] If the business has a large presence in Florida but a small one in New York, spare capital nevertheless languishes in the coffers of the New York Department of Financial Services. Related to this problem is the issue of non-overlapping licensure requirements. Each state has its own expensive way of creating consumer protections. For example, while Florida may require less in surety bonds, it makes up the difference by requiring far more than New York in terms of reporting and compliance. Florida requires both financial audit reports and a BSA/AML compliance officer, which is not required by New York.[102] The hard work of complying in one state often does not carry over to the next. Finally, as alluded to above, the different licensing requirements may lead to some form of regulatory arbitrage. Even this limited sample of five states yields significant variation in regulatory oversight, with Texas choosing to leave cryptocurrencies untouched, New York regulating a broad swathe of ecosystem participantism, and California trying to promote a gentler version of New York BitLicense to attract more cryptocurrency businesses. While instances of regulatory arbitrage have yet to materialize, the possible formation of safe havens may undercut any benefits that might accrue from a single state's well-crafted regulation. Multi-state money transmitter regulation thus offers expensive, redundant, and uneven protections for the nation's consumers.

In short, a qualitative cost-benefit analysis would support state regulation for businesses storing and

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[100] *See* TEX. FIN. CODE ANN. § 151.003(10) (West 2015) (not requiring a money services license for "any . . . person, transaction, or class of persons or transactions exempted by commission rule or any other person or transaction exempted by the commissioner's order on a finding that the licensing of the person is not necessary to achieve the purposes of this chapter").

[101] *See* Brown, *supra* note 66, at 26, 83.

[102] *See id.* at 25.

transmitting new forms of value as their primary activity, but much more targeted state regulation for businesses where money transmission is only incidental to the core activity. In both cases, however, fragmented state regulation yields uncertain benefits at large costs to startups, and hence to consumers. The following section discusses proposals to tailor existing regulations to payments startups and optimize the cost-benefit trade-off to consumers.

V. TWO PROPOSALS COULD LOOSEN THE CHOKING GRIP OF STATE REGULATION

An optimal regulatory regime should retain the broad scope of money transmitter law at the state level, but introduce more standardization around exemptions and licensure requirements. While the FinCEN registration process should be kept in place, since it only requires a single application with no fees, we need to build on the foundations for a streamlined system to reduce duplicative state licensing costs and processes. At a minimum, states need to adopt particular exemptions that would allow businesses with low consumer risk to avoid licensure. States should also consider adopting a temporary waiver program for businesses meeting specified criteria and delay licensure until those businesses reach a certain size. Finally, and perhaps most adventurously, states should build on the growing National Mortgage Licensing System (NMLS) database to implement "passporting" of licenses.

A. Promote Adoption of Key Exemptions in Each State

Two specific exemptions can likely go a long way to reducing the regulatory burden on payments startups, without sacrificing too much in the way of consumer protection. There is a significant collective action problem, but standardization is slowly occurring through the efforts of the Money Transmitter Regulator Association,[103] and to some extent the Uniform

[103] *See* MONEY TRANSMITTER REGULATORS ASSOCIATION, http://www.mtraweb.org [https://perma.cc/W2D5-MHRV] ("MTRA is a national non-profit organization dedicated to the efficient and effective regulation of money transmission industry in the United States of America. The MTRA membership consists of state regulatory authorities in charge of regulating money transmitters and

Money Services Act. The key lies in focusing amendment efforts around the following exemptions.

First, states should draft an explicit agent-of-a-payee exemption, following in the footsteps of New York, Nevada and Ohio.[104] California recently amended its Money Transfer Act to include such an exemption.[105] North Carolina has followed suit, proposing an agent-of-the-payee exemption along with a host of other friendly amendments that would narrow the scope of its money transmitter laws.[106] Other states have not formally introduced proposals exempting agents, but have started moving down that path. The Illinois Department of Financial and Professional Regulation, after rocking the payments world with its cease-and-desist orders in 2013, announced this year that third-party payment processors were no longer required to apply for licensure.[107] This could have been due to the possibility of depriving Illinois citizens of access to Square, a concern that was reflected in the agency's policy statement.[108] More states should follow suit to maximize benefits delivered by incidental transmission businesses, since the existing risk to consumers is limited. Some states have issued voluminous guidance on transactional structures that can qualify for agent-of-the-payee exemptions. California, for example, hooks its requirements back into the state's definition of an "agent".[109] It also looks favorably on existing written agreements between creditors and the money transmitter that expressly appoint the transmitter as "its agent for the limited purpose of receiving payments on its behalf from [its customers]."[110]

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sellers of traveler's checks, money orders, drafts and other money instruments.").

[104] *See* Kevin V. Tu, *Regulating the New Cashless World*, 65 ALA. L. REV. 77, 129 (2013).

[105] *See* Cal. A.B. 2209 § 3(*l*), *supra* note 62.

[106] *See* Austin Mills, *A North Carolina Proposal Can Cure Payments' Regulatory Overreach*, PAYMENTSSOURCE (May 15, 2015), http://www.paymentssource.com/news/paythink/a-north-carolina-proposal-can-cure-payments-regulatory-overreach-3021341-1.html [https://perma.cc/2HMK-2HRL].

[107] *See Third-Party Payment Processors*, IDFPR, *supra* note 75.

[108] *See id.* ("Rapidly evolving payment technologies present great benefits for Illinois consumers . . . To ensure that new technologies are readily available in Illinois, we must establish a regulatory framework that does not impose unnecessary barriers, and the associated costs and delays, to technological innovation.").

[109] *See* CAL. FIN. CODE § 2010(l)(1) (West 2016) ("'[A]gent' has the same meaning as that term is defined in Section 2295 of the Civil Code.").

[110] Opinion Letter, *Exemption for Agent of Payee Payment-Processing Service*, CALIFORNIA DEPARTMENT OF BUSINESS OVERSIGHT 2 (Sept. 11, 2015),

Additionally, states could adopt authorized delegate exemptions. Under this rule, potential money transmitters would be able to operate without a license if they are "designated or appointed by [a licenseholder] pursuant to a written agency contract to engage in money transmission activities."[111] This provision is available in Arkansas, New York, Texas, Virginia, and Washington, and the trend appears to be growing among states.[112] This could offer a safe path between the Scylla of full registration and the Charybdis of non-compliance for startups. The startup can effectively rent a license through a much less bureaucratic process, and likely at a lower cost. The licenseholder becomes responsible for conducting due diligence on the licensee and fulfilling recordkeeping and retention on behalf of the licensee.[113] Scale economies might also be achieved if renting licenses becomes a core business activity for the licenseholder. Anecdotally, authorized delegation appears to be a motivating factor in combinations of payments businesses over the past few years, as companies merge to create a national portfolio of money transmitter licenses.

There are risks associated with such a provision. Chief among them is centralization of supervisory responsibility with a potentially incompetent, or even downright fraudulent, private third party. Sigue, a remittance business that had more than 7,000 authorized delegates, was fined for failing to establish an anti-money laundering program reasonably compliant with the BSA.[114] Meracord, a third party payment processor, designated a number of debt-relief companies as authorized delegates. It allegedly provided substantial assistance to certain debt service relief providers which were charging and collecting unlawful advance fees from

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http://www.dbo.ca.gov/Laws_&_Regs/dfi_orders_files/2015/Redacted_Letter_opinion_request_Exemption_91115.pdf [https://perma.cc/9P3M-PJ39].

111 N.Y. BANKING LAW §§ 640(10), 648(b) (McKinney 2016).

112 *See* Rinearson *et al.*, *supra* note 64.

113 *See* Judith Rinearson, *Surprise: State Licensing Laws Could Help Payments Innovation*, AMERICAN BANKER (Dec. 17, 2014), http://www.americanbanker.com/bankthink/surprise-state-licensing-laws-could-help-payments-innovation-1071697-1.html [https://perma.cc/S3V3-FJD6].

114 *See* Press Release, *Sigue Corp. and Sigue, LLC of California to Pay $15 Million to U.S. Government for Anti-Money Laundering Program Deficiencies*, FINCEN (Jan. 28, 2008), https://www.fincen.gov/news_room/nr/html/20080128.html [https://perma.cc/4CP4-S8NH].

consumers.[115] Nevertheless, a well-managed authorized delegation regime would focus regulatory attention on the primary licenseholders, instead of spreading regulatory effort thinly across thousands of potential money transmitters. Such a regime could be modeled on Texas' position on authorized delegates. Texas has clarified that authorized delegate status depends on 1) the control relationship between the licenseholder and its delegate; 2) the nature of the delegate's business; 3) the flow of fees between licenseholder and delegate; and 4) the presence of a contractual relationship between the customer and the licenseholder.[116] This could forestall some of the more egregious abuses of widespread authorized delegation.

B. Design Federal and State Waiver Programs for Deserving Startups

Alternatively, regulators could offer limited waivers of liability for startups, at either the state or federal level. Currently, FinCEN and many states offer opinion letters that instruct businesses on whether money transmitter registration is required for their business model. Liability waivers go one step further, and would offer time-delimited, carefully-tailored indemnities for "deserving" businesses. Whether or not a business deserves temporary relief from licensure depends on the stated goals of the state's money transmitter laws, with specific criteria for such a waiver left to the commissioner's discretion.

This would be a novel approach, but an analogous program is already being offered by the CFPB. The CFPB "approve[s] individual companies, on a case-by-case basis, for limited time exemptions from current federal disclosure laws in order for those companies to research and test informative, cost-effective disclosures."[117] The results are shared back with the CFPB, and used to tailor more effective regulations to protect consumers. The scope of the exemption is broad:

115 Complaint at 4, CFPB v. Meracord, No. 3:13-cv-05871 (W.D. Wash. Oct. 3, 2013).

116 *See* Supervisory Memorandum 1038, *supra* note 65, at 2-3.

117 Press Release, *CFPB Proposes Allowing Companies to Run Trial Disclosure Programs*, CFPB NEWSROOM (Dec. 13, 2012), http://www.consumerfinance.gov/newsroom/consumer-financial-protection-bureau-proposes-allowing-companies-to-run-trial-disclosure-programs [https://perma.cc/4MVR-4PBW].

"[Approved] entities . . . should not face private liability exposure for violating those provisions of [the waived] federal disclosure statute or rule . . . [this also] applies to other federal and state regulators even if they have enforcement or supervisory authority as to the 'enumerated consumer laws' for which the Bureau has rulemaking authority."[118] This is an exciting new approach to harness the innovative power of startups for consumer benefit, while constantly providing a test-and-learn environment to shape financial disclosure regulation.

States could similarly offer limited time exemptions from state money transmitter laws if applicants pass the test. Possible factors for consideration include the size of transaction efficiency gains for consumers, the extent to which the program minimizes risk to consumers and money laundering risk, and the contribution towards developing more cost-effective money transmitter regulation. There are modest benefits to having each state implement its own waiver program, since at the very least the expensive capital requirements of licensure would be removed. However, this proposal becomes truly transformative if the test factors are standardized and administered at the federal level by FinCEN, since it would mean a single successful application would provide temporary relief from multi-state compliance. This would give startups some time to test their business models and gain enough runway to commence registration in their core markets. From a state perspective, state regulators could focus on defining the characteristics of startups that provide more benefits than costs, and grant waivers on a case-by-case basis without opening the floodgates to bad actors or requiring state legislatures to pass lengthy amendments.

C. Standardized Licensing Requirements Through NMLS

Significant redundancy and waste occurs when each state imposes different licensing requirements, ongoing compliance, and reporting procedures. Yet requiring states to implement an EU-like "passporting" system is overly

[118] Garry Reeder, *Policy to Encourage Trial Disclosure Programs; Information Collection*, No. CFPB-2012-0046, CFPB (Dec. 10, 2012), http://files.consumerfinance.gov/f/201212_cfpb_trial_disclosures.pdf [https://perma.cc/28J3-9YFD].

adventurous. The European Commission's Payment Services Directive "establish[es] a single license for all providers of payment services which are not connected to taking deposits or issuing electronic money" ("payment institutions").[119] This effectively creates reciprocal licenses allowing payments institutions to use their home license as a "passport" to operate in other countries. In the U.S., such a system is unlikely to gain state support, and might emerge only as a result of federal pre-emption of state law.

There could be a middle ground that allows states to retain a significant say in local licensing procedures, while reducing redundancy and waste in the licensing process. The cornerstone of such a solution lies in the National Mortgage Licensing System (NMLS). This database was originally created to track mortgages, but is increasingly being used to track money transmitter licenses across states and facilitate information sharing between regulators.[120] Most states are now using NMLS to manage money transmitter licensing applications,[121] and many are also requiring existing license holders to migrate their licenses into the database to facilitate easy tracking.[122] NMLS is evolving into a common application for money transmission licenses from participating states, even though each state still retains its own unique licensing requirements. At the very least, it will streamline the application process to the benefit of applicants.

To build on this development, bodies such as the Money Transmitter Regulators Association (MTRA) or the Conference of State Bank Supervisors (CSBS) could identify greatest pain points in the application process, and harmonize them with their sister states. For example, presenting regular audited financial statements to all states through NMLS might

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119 Parliament and Council Directive 2007/64/EC, On Payment Services in the Internal Market Amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC and Repealing Directive 97/5/EC, 2007 O.J. (L 319) 1, 2, http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:32007L0064 [https://perma.cc/BMY7-4C82].

120 *See* Rinearson *et al.*, *supra* note 64.

121 *See* NMLS Resource Center, *States Expand Use of NMLS to New Industries*, NATIONWIDE MULTISTATE LICENSING SYSTEM & REGISTRY (Jan. 27, 2016), http://mortgage.nationwidelicensingsystem.org/news/Pages/ExpandedUse.aspx [https://perma.cc/T5CR-5F9U].

122 *See, e.g.*, *Managing Your License on NMLS*, CALIFORNIA DEPARTMENT OF BUSINESS OVERSIGHT (Jan. 15, 2016), http://www.dbo.ca.gov/Licensees/money_transmitters/Transitioning%20Licensees-%20Website.pdf [https://perma.cc/543V-5ZJ2] (announcing that the DBO would start using NMLS to manage money transmitter licenses on January 15, 2016).

conceivably earn leniency on the surety bond or net worth threshold, if the states agree that it decreases consumer risk. Another possibility would be to aggregate surety bond amounts within a central fund that pays out proportionately to member states, should the money transmitter end up in trouble. This could have the benefit of coordinating oversight efforts, while also reducing the administrative and financing costs of putting up multiple surety bonds in different locations. None of these harmonizations are easy, but they would formalize the existing information exchanges between state regulators, create more transparent and uniform protections for consumers, and also reduce the burden on startups' licensing efforts.

VI. CONCLUSION

Money transmitter regulation need not be the insuperable challenge many entrepreneurs paint it to be. In fact, the need for well-tailored and standardized regulation will only become more acute, as innovators develop newer and more complicated ways of exchanging value over the Internet. However, the current state of regulation is undeniably inhibiting valuable innovation, forcing startups to spend dollars on lawyers instead of inventions.

The distinction between new money and incidental transmission is crucial. New money needs not just more regulation, but also smarter regulation. It would be sheer negligence to *not* regulate decentralized, private and untraceable money. Incidental transmission, too, deserves oversight when large amounts of consumer funds are at risk. However, regulators and legislators should continue to fine-tune their regulatory programs to achieve a good balance between consumer financial protection on the one hand, and access to financial innovation on the other. There needs to be a push towards harmonization and standardization to capture the full range of benefits for consumers. This could take the form of independent efforts to mirror useful exemptions introduced by sister states; a waiver program, launched in financial centers and innovation hubs such as California and New York; or an ambitious expansion of NMLS' potential. All these will go a long way to incenting innovation without losing oversight of new businesses.