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Viewpoint

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Money Laundering and Prepaid Access: Thoughts on FinCEN's Proposed Rulemaking

By Courtney J. Linn, Of Counsel, Orrick, Herrington & Sutcliffe

In late June of this year, the Financial Crimes Enforcement Network (FinCEN) issued a notice of rulemaking proposing to bring prepaid access providers and sellers within the reach of the Bank Secrecy Act's (BSA) core anti-money laundering (AML) provisions. The proposed regulations come after years of regulatory inaction. Previously, FinCEN had made the studied decision not to impose the most onerous BSA obligations on the prepaid card industry so as not to stifle innovation. FinCEN has reevaluated that decision under pressure, perhaps, from two quarters: (1) Congress, which had issued a call for AML regulation when enacting the CARD Act, and (2) federal and state law enforcement communities. In fact, it was a state attorney general, not FinCEN or any other federal official, who almost single-handedly put the issue of AML regulation for prepaid card providers and sellers on Congress' legislative agenda.

Paybefore asked me to offer some initial thoughts on the proposed regulation. I write from the perspective of someone who formerly worked in law enforcement. In the interest of disclosure, I previously have advocated for treating prepaid cards as "monetary instruments" for purposes of currency and monetary instrument reporting (CMIR). I also have written about how the government uses a little known statute—18 U.S.C. § 1960—to prosecute unlicensed money services businesses (MSBs).

Defining Who Is a Provider of Access

One reason FinCEN was slow to regulate prepaid access is that for years it did not know who to regulate. A prepaid access transaction fractures into many parts. It can involve the network, distributor, issuing bank, program sponsor, program manager, processor and retailer. Each participant in the transaction has data or other information that may help identify money laundering and terrorist financing transactions conducted using prepaid access devices. Before now, however, only the issuing bank faced extensive BSA regulation and oversight.

The proposed regulations address the question of who to regulate by placing the regulatory burden on the "provider" and the "seller" of prepaid access. But as FinCEN discovered when it examined the prepaid card industry, the products and transaction processes are varied, making it difficult to write a rule that identifies the "provider" with precision. FinCEN has responded to this challenge by writing something akin to a "we'll know the provider when we see it" definition.

I see at least two problems with this approach. First, the regulations may not give the industry sufficient guidance. There will be confusion and uncertainty as to who within the

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Money Laundering and Prepaid Access: Thoughts on FinCEN's Proposed Rulemaking

transaction flow is the "provider" and thus bears the great weight of the regulatory burden. As discussed below, participants in a prepaid card transaction face potentially serious civil and criminal penalties if they misapprehend who FinCEN ultimately may consider the provider to be. FinCEN's flexible definition leaves too much room for second guessing and finger pointing if the worst happens.

Second, in identifying the "provider" in a prepaid access transaction, FinCEN might give more deference to the program participants' views. The proposed regulations suggest that FinCEN will not be cowed by the program participants' decisions about who within the transaction cycle should bear the BSA burden. But far from reaching an "arbitrary decision," the program participants will reach an economically rational one. They will have bargained-for expectations. In other words, they will allocate the BSA obligation by contract and the obligation will be priced into a program participants' products or services. Unless the parties' allocation of BSA responsibility is a ruse or an elaborate shell game (neither of which seems likely given the reputation and other risks involved), then in the absence of a more precise regulatory definition, FinCEN should give at least some deference to the participants' choice.

Sellers of Prepaid Access

That FinCEN would chose to extend the full range of BSA requirements to "providers" of prepaid access comes as no surprise. More surprising is the proposal extending many of the most burdensome BSA provisions to "sellers," including the suspicious activity report (SAR) filing requirement, maintaining an effective AML program requirement and customer identification requirements. As FinCEN explains, "the seller will typically be a general-purpose retailer, engaged in a full spectrum product line through a business entity such as a pharmacy, convenience store, supermarket, discount store or any of a number of others." The regulations, thus, have the potential to extend the BSA to virtually every general-purpose retailer in the United States that sells prepaid access. The proposed regulations represent perhaps the most dramatic example to date of how the boundary between trades or businesses, which generally are subject only to a currency reporting requirement known as a Form 8300, and banks and nonbank financial institutions (NBFIs), which are subject to a vast array of BSA requirements, continues to erode.

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The problem I foresee is one of education, examination and enforcement. It's one thing to impose a BSA obligation; it's quite another to educate the regulated community about the obligation and examine the community for compliance. When FinCEN extends regulations to NBFIs, it stands on the edge of a regulatory feather. In most such instances, it does not have a federal functional regulator to help implement the regulatory requirement. FinCEN learned this lesson when it first imposed BSA obligations on NBFIs, particularly money services businesses (MSBs). Initially, at least, FinCEN and IRS-Small Business/Self-Employed (SB/SE) lacked the resources and infrastructure to provide meaningful education and oversight to the MSB community. The same may prove true here. The universe of "sellers of prepaid access" is potentially so large that it raises anew the question whether FinCEN and IRS-SB/SE can keep pace with the demands of its own rulemaking.

The Registration Requirement

Issuers and redeemers of stored value were previously exempted from the registration requirement that applies to MSBs. (See 31 U.S.C. § 5330 & 31 C.F.R. § 103.41.) In the case of providers of prepaid access, the rulemaking proposes to eliminate the exemption, extending the registration requirement to this sub-class of MSBs.

The proposal may fall into the category of "if a regulatory requirement does not work, extend it." The MSB registration requirement has not been particularly effective. Only an unknowable fraction of the total universe of MSBs bothers to register with FinCEN, and neither FinCEN nor IRS-SB/SE has the resources to do much to enforce the MSB registration requirement. In fact, in the proposed regulations FinCEN doesn't even try to defend the registration requirement on the grounds that regulators need the information. Instead, FinCEN speaks of correcting

Money Laundering and Prepaid Access: Thoughts on FinCEN's Proposed Rulemaking

"market imbalances" and writes:

> *FinCEN anticipates that identifying information about the component entities involved in a prepaid program will be fundamentally important to the law enforcement community. We believe that the most efficient way to obtain this information and make it available for law enforcement use is via the registration process.*

In other words, FinCEN views the registration requirement primarily as an information-gathering tool for law enforcement. The completed registration form provides another set of data to add to the huge mass of data in the Currency and Banking Retrieval System (the IRS online database that houses BSA data), where it can be manipulated with still more data from other sources.

We have moved past the day when a privacy objection alone might dissuade FinCEN from imposing a requirement for no better reason than to gather information for law enforcement. And concededly, the regulatory burden of completing a registration form is minimal—FinCEN estimates it takes about 2.5 hours once every two years. These are not my primary concerns. The concern I have is one of enforcement. A person operating a "money transmitting business" without having registered with FinCEN is subject to serious criminal penalties for failing to register even if the person was unaware of the registration requirement and that the failure to register was a crime. (See 18 U.S.C. § 1960.) Though not a strict liability statute (see, e.g., *United States v. Talebnejad*), Section 1960 comes very close to defining a criminal offense without any mental intent element. This raises two questions. First, are providers of prepaid access engaged in "money transmitting" within the meaning of Section 1960? The rulemaking suggests that if they are not money transmitters they share many common characteristics. Second, is FinCEN's test for identifying the "provider" of prepaid access too vague and elastic to give fair notice of the potential for criminal liability if a prepaid access provider fails to register?

It would help if FinCEN drafts the registration requirement with Section 1960 in mind. FinCEN likely would take the position that Section 1960 is "not a Treasury statute," and thus outside its purview. But there it is all the same. It exists in part to enforce the BSA's registration requirement for MSBs and the regulations that implement it. Most of the time when Congress defines a regulatory-type offense, it does so using a heightened mental intent element (see, e.g., 31 U.S.C. § 5322) to avoid ensnaring innocent conduct. As explained, the criminal statute used by the government to enforce the MSB registration—Section 1960—uses a watered-down mental intent element. For that reason, when writing regulations imposing or extending the registration requirement, FinCEN has an especially strong obligation to write with clarity and precision.

International Transportation of Prepaid Access

In May 2009, Congress enacted the CARD Act. Section 503 required Treasury, in consultation with the Department of Homeland Security (DHS) to issue final regulations regarding stored value products, which may include regulations on the international transportation of "stored value cards." The transportation of prepaid access products across the border has captured Congress' attention. Several legislative proposals are pending in Congress that would extend the CMIR requirement to what Congress still terms "stored value" products, a term FinCEN treats as being the equivalent of its preferred term, "prepaid access." In the proposed rulemaking, FinCEN acknowledges that Congress has asked it to examine extending the CMIR obligation to prepaid access devices.

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Money Laundering and Prepaid Access: Thoughts on FinCEN's Proposed Rulemaking

But it has decided to defer the issue to another rulemaking. In its words, "FinCEN recognizes the value of collecting information in international transactions and payment flows, and is engaging with the Department of Homeland Security and other members of the law enforcement community in an attempt to identify appropriate solutions."

FinCEN's statement about deferring the CMIR regulations to engage further with the DHS is government speak for: "You try working with DHS on this issue." It hints at a larger structural problem in how the government makes regulatory policy in the CMIR area. Prior to the Homeland Security Act of 2002, the Treasury department had a bevy of law enforcement agencies, including the key law enforcement agencies responsible for border and customs enforcement. Back then, it made sense for Treasury to exercise regulatory authority over CMIR enforcement because Treasury agencies were the ones at the border enforcing the CMIR regime. As the result of the Homeland Security Act, however, this is no longer true. Most of Treasury's law enforcement agencies migrated to other departments of government, leaving Treasury with only a handful of criminal law enforcement agencies. In particular, former Treasury agencies with a direct stake in CMIR enforcement issues have been absorbed into DHS. Yet, Treasury retains the regulatory keys to the CMIR regime (and by extension the bulk cash smuggling statute).

When one department of government has the authority to write the regulation, but another department of government has the authority to enforce the regulation, simple disagreements can disintegrate into interdepartmental warfare. Memos are written, meetings are held, assistant secretaries are briefed and nothing happens. If DHS wants to treat prepaid cards at the border as "monetary instruments" and Treasury wants to treat them as "access devices," it could take a cabinet-level meeting to sort out what amounts to a technical issue. Regrettably, a subject that Congress deemed important enough to direct Treasury and DHS to examine on a tight time schedule has been put indefinitely on the regulatory back burner.

Meaning of the Term "Prepaid Access"

FinCEN proposes a definition of "prepaid access" with sufficient "regulatory elasticity to survive future technological advancements."

> *Specifically, we propose defining "prepaid access" as an electronic device or vehicle, such as a card, plate, code, number, electronic serial number, mobile identification number, personal identification number or other instrument that provides a portal to funds or the value of funds that have been paid in advance and can be retrievable and transferable at some point in the future.*

Again, I have concerns that in its desire to achieve regulatory flexibility, FinCEN has not provided the industry with sufficient guidance. The concept of a "personal electronic number" that provides a "portal to funds" that have been "paid in advance" and are "retrievable" in the future could sweep in a host of Internet-based financial transactions. It is hard, in fact, to separate FinCEN's definition from what consumers do each time they access their bank accounts via the Internet. FinCEN emphatically did not intend to sweep ordinary banking transactions into this proposed rulemaking. At the same time, FinCEN intended to regulate some forms of electronic or Internet-based debit transactions, particularly those done through mobile payment devices.

One difficulty with regulating Internet-based payment transactions is extra-territoriality. Does FinCEN intend the proposed regulation to apply to a foreign-based prepaid access provider that sells prepaid access devices in the United States via the Internet or otherwise? How do regulators and law enforcement agencies enforce a registration requirement and BSA/AML obligations against foreign-based prepaid access providers or sellers? Better yet, how does IRS-SB/SE examine foreign providers or sellers for compliance with the BSA?

These are my preliminary reactions. No doubt as the comment period nears closure (Aug. 27, 2010), FinCEN will receive many more. But if FinCEN wants regulatory flexibility, it has to be prepared for the uncertainty that comes with it.