



**PREPARED REMARKS OF JAMES H. FREIS, JR.
DIRECTOR, FINANCIAL CRIMES ENFORCEMENT NETWORK
U.S. DEPARTMENT OF THE TREASURY**

**DELIVERED AT THE MONEY TRANSMITTER REGULATORS ASSOCIATION
2010 ANNUAL MEETING AND EXAMINERS' SCHOOL**

**OLYMPIC VILLAGE, CA
SEPTEMBER 1, 2010**

I would like to spend our time together this morning sharing what FinCEN is trying to do with our efforts to bring a more comprehensive Bank Secrecy Act/Anti-Money Laundering (BSA/AML) regime to the prepaid access industry.

Prepaid products, also known as stored value, stored value cards, or prepaid cards, have become widely accepted products within the financial system in recent years, and for very good reasons. Not only are these products popular with consumers for convenience and security reasons, there are also benefits for the businesses, employers, governments, and banks that issue and market these products.

One reason these products are widely used is that plastic is often regarded as a type of validation into the mainstream of the U.S. financial system. Without them, consumers can't shop online or reserve a hotel room. And for the unbanked – one of the only other options is operating on a cash-only basis, which presents its own risks, or purchasing money orders or cashier's checks, which are less flexible and may carry an additional expense.

As with any new product entering or evolving within the financial marketplace, new risks to the U.S. financial system may be created. And the lack of financial transparency inherent in stored value products makes it difficult to assess the money laundering risks and abuses. So, why regulate the financial industry? We do so because any way you can move money, criminals will find a way to abuse it.

Why am I addressing the topic of prepaid access to the Money Transmitter Regulators Association? The reason is that we at FinCEN believe that the risks and appropriate regulatory framework to attempt to mitigate those risks is to consider prepaid access as a type of money transmission. Let me clarify something critical here – the framework for money transmission – and that which we propose for prepaid access – is an activity-based test. More specifically, we are looking at the ability to introduce value - and to realize

that value at some subsequent time, different place, by a different person, for a subset of the original amount, or some combination of the foregoing.

This is technology neutral and is meant to be adaptable to a range of products, whether tied to a plastic card, an internet system, or a mobile phone network (this also recognizes that alternative models, in particular early prepaid products in the 1990s, where the value was transferred physically through cash-like bearer instruments have largely failed to develop as commercially viable).

History

Before we discuss our most recent actions in this area, let's take a moment to step back to see the foundation upon which new prepaid access rules will be built.

Development of MSB Regulatory Framework

When FinCEN issued its first rule regarding money services businesses (MSBs) over a decade ago, it limited certain requirements for the prepaid or stored value arena based on varied and emerging business models, and the desire to avoid unintended consequences with respect to an industry then in its infancy. The limited regulatory framework put into place in 1999 applied to certain prepaid products as part of the MSB regulations applicable to sellers, issuers, and redeemers of stored value.¹

Therefore, unlike most other categories of MSBs, an issuer, seller, or redeemer of stored value has not been required to register as an MSB with FinCEN² or to file SARs.³ However, an issuer, seller or redeemer of stored value - as defined by our current regulations⁴ - is required to file CTRs,⁵ and to establish a written AML program, including policies, procedures, and internal controls commensurate with its activities and reasonably designed to prevent it from being used to facilitate money laundering and the financing of terrorist activities.⁶

As administrator of the BSA, FinCEN has delegated authority to the Internal Revenue Service (IRS) to examine the MSBs for compliance with BSA requirements, including those falling within the scope of FinCEN's regulations with respect to stored value.⁷ Although the BSA is not directly enforced by State agencies, the examination process in some states evaluates compliance with Federal regulations, including the BSA. Additionally, State agencies are charged with enforcing state statutes and regulations that apply to MSBs, which may impose requirements that overlap with the BSA. Therefore, State regulators may examine MSBs for compliance with certain BSA requirements, possibly including compliance with the AML program requirement, as elements of a

¹ See 64 FR 45438 (Aug. 20, 1999) http://www.fincen.gov/statutes_regs/frn/pdf/msbreg1.pdf

² 31 CFR 103.41(a).

³ 31 CFR 103.20(a)(1).

⁴ 31 CFR 103.11(uu)(3) and (4).

⁵ 31 CFR 103.22(b)(1)

⁶ 31 CFR 103.125(a).

⁷ 31 C.F.R. § 103.56(b)(8).

more comprehensive list of compliance requirements imposed under State law. These requirements, however, vary from state to state.

Revamp of MSB Definitions and Recognition of Maturity of Stored Value Market

So, given this regulatory framework, why did FinCEN feel a revamping of the MSB definition was necessary in 2009? Our intent with the revamp was to incorporate language contained in multiple past administrative rulings into the regulatory text. In addition, we felt it was important to more precisely describe what underlying activity would subject an entity to the BSA rules.

With this as a backdrop, FinCEN issued a Notice of Proposed Rulemaking (NPRM) on May 12, 2009, regarding definitions and other regulations relating to MSBs. The NPRM solicited comments on stored value to assist FinCEN with a future rulemaking proposing a revised definition of stored value and revising related regulations.⁸

Specifically, in our 2009 NPRM, FinCEN hoped to gather information in the following areas:

- The appropriate way to define “stored value”;
- The pros and cons of regulating stored value as a form of money transmission; and
- The propriety of regulating both open and closed loop forms of stored value; and various other questions.

The comments FinCEN received on the 2009 NPRM covered a significant range of opinions. A consumer rights organization and an association of State regulatory agencies urged a more rigorous regulatory scheme, encompassing any and all types of prepaid business models. The comments received from business entities in the prepaid industry generally suggested that closed loop products should not be encompassed within the proposed rulemaking because they posed very minimal money laundering risk. They asserted that stored value/prepaid products are often wrongly categorized as monetary instruments and, while more closely allied with money transmission, they most accurately deserve a separate category as a form of money transmission. The comments received have certainly assisted FinCEN in drafting the current rulemaking.

The Prepaid Access NPRM

One of our biggest challenges on the regulatory front generally is to find a way to strike the right balance. A balance between expanding financial inclusion and ensuring financial transparency for law enforcement, while staying mindful of the obligations and costs to the industry in complying with regulatory requirements – and the related potential inconvenience passed down to customers. So, for several years, FinCEN has

⁸ See <http://edocket.access.gpo.gov/2009/pdf/E9-10864.pdf>

been working with law enforcement, other regulators, and the financial industry to study the stored value/prepaid card industry.

Recognizing the importance of bringing a pool of experts together on this issue, in May 2008 FinCEN formed a subcommittee to focus on stored value issues within the Bank Secrecy Act Advisory Group (BSAAG). The BSAAG is a forum created by Congress to bring together representatives from the financial industry, law enforcement, and the regulatory community to advise FinCEN in its regulatory functions. The stored value subcommittee gave us a ready forum of experts available and willing to consult on these issues.

And what have we learned? For one, many of the same factors that make prepaid access attractive to consumers make it vulnerable to criminal activity. For instance, the ease with which prepaid access can be obtained combined with the potential for relatively high velocity of money through accounts involving prepaid access and anonymous use, may make it particularly attractive to illicit actors. These individuals value the ability to receive and distribute a significant amount of funds without being subject to many of the reporting or recordkeeping requirements that would apply to similar transactions using cash or involving an ordinary demand deposit account at a bank.

In developing this most recent NPRM to propose a more comprehensive BSA/AML regime on the nonbank prepaid access industry, we worked closely throughout the process with our law enforcement and regulatory counterparts, meeting throughout 2008-2009 as often as three to four times each month to collaborate on these issues.

Once again, why was the current rulemaking necessary? First, our discussions with law enforcement during this time highlighted that prepaid products may be increasingly used for illicit purposes. Second, the regulations had not kept pace with the technology and innovation and it was time to propose a more comprehensive regime.

Also, on May 22, 2009, President Obama signed the Credit Card Accountability, Responsibility, and Disclosure (CARD) Act of 2009.⁹ Section 503 of the CARD Act directs that FinCEN, as administrator of the BSA, issue regulations regarding the sale, issuance, redemption, or international transport of stored value, including prepaid devices such as plastic cards, mobile phones, electronic serial numbers, key fobs and/or other mechanisms that provide a portal to funds that have been paid for in advance and are retrievable and transferable. And while FinCEN had already begun to research and prepare for a rulemaking long before the CARD Act of 2009, the statute accelerated our timeframe greatly.

After extensive study and collaboration with the law enforcement and regulatory communities, on June 28, 2010, FinCEN issued its NPRM which proposed new rules that would establish a more comprehensive regulatory framework for non-bank prepaid access.¹⁰

⁹ See <http://www.gpo.gov/fdsys/pkg/PLAW-111publ24/pdf/PLAW-111publ24.pdf>

¹⁰ See <http://edocket.access.gpo.gov/2010/pdf/2010-15194.pdf>

Under FinCEN's proposal, non-bank providers of prepaid access would be subject to comprehensive BSA regulations similar to depository institutions. To make BSA reports and records valuable and meaningful, the proposed changes impose obligations on the party within any given prepaid access transaction chain with predominant oversight and control, as well as others who might be in a position to provide meaningful information to regulators and law enforcement, such as prepaid access sellers.

Among the major features of the proposal are:

- Renaming "stored value" as "prepaid access" to allow for future changes in technology and prepaid devices;
- Making this newly defined "provider" of prepaid access a responsible party subject to regulation.
- Placing registration requirements on providers of prepaid access and suspicious activity reporting, customer information recordkeeping, and new transactional recordkeeping requirements on both providers and sellers of prepaid access; and
- Exempting certain categories of prepaid access products and services posing lower risks of money laundering and terrorist financing from certain requirements.

This last aspect is key to our efforts to achieve the right balance. Certain prepaid programs operate in such a way as to reduce potential money laundering threats and are therefore, generally not subject to the provisions of the NPRM. Products such as payroll cards, government benefits cards, health care access cards, closed loop cards, and those products that clearly state on the instrument that they can access \$1,000 or less, are excluded.

Other risk indicia - such as whether a product is reloadable, can be transferred to other consumers, or can be used to transfer funds outside the country - were all things that we identified through our extensive regulatory, law enforcement, and industry consultations. With the NPRM, we asked the general public to help validate whether we have found the right balance so that higher-risk persons and products will be appropriately regulated while lower risk products would not be subject to undue regulatory costs or constraints.

The NPRM is designed to be flexible and to accommodate new technologies as they emerge. Prepaid access can include cards, electronic serial numbers or codes, mobile phones, key fobs and other yet-to-be-invented devices.

The comment period for the NPRM officially closed just a few days ago on August 27, 2010. FinCEN received over 70 comments from interested parties and is currently in the process of reviewing the information provided in those comments. Generally, the

comments focused on issues such as the difficulty in identifying which party is acting in a provider role, the inclusion of retail sellers within the scope of the rule, and the difficulties perceived by the industry in inhibiting closed loop cards to domestic use exclusively.

MSB Outreach

Late last year, FinCEN also concluded an outreach effort with some of the nation's largest MSBs, and a little over one month ago issued a report to share insights that were gathered during the course of this outreach.¹¹ One key take-away we noted during the course of our outreach was that being in compliance with BSA regulations is consistent with the interviewed MSBs business models. Such compliance in turn assists FinCEN in providing more targeted information to law enforcement investigators.

FinCEN also found that the interviewed MSBs place a significant emphasis on agent oversight and compliance, and that maintaining their reputations and the trust of their customers is a core objective of their business models.

I encourage those of you who have had not yet had the opportunity to review the report to visit FinCEN's website. The report also contains an appendix summarizing the various resources available to MSBs to assist in their compliance with the BSA, including links to both the [Bank Secrecy Act/Anti-Money Laundering Examination Manual](#), released in December 2008, and the July 2010 translation of the manual into [Spanish](#).¹²

Future Steps

As FinCEN continues to study the comments received on the NPRM with regard to stored value, we must also be mindful that global solutions also must be pursued. Domestic action alone will not be sufficient to solve the vulnerabilities posed by these new technologies, since many problematic products are issued by offshore financial institutions, which can then be obtained and used domestically.

Our law enforcement partners report abuses of these products and anticipate further misuse as the industry grows and we continue to work with our counterparts in the law enforcement community to identify ways to achieve greater transparency of international transport of prepaid access.

While we continue to believe the regulatory framework proposed in the NPRM will set the best broad foundation, we are also certain that through the comments and ongoing dialogue, there will be a need for further clarification going forward.

FinCEN also has engaged with our foreign counterpart financial intelligence units (FIUs) and anti-money laundering/counter terrorist financing (AML/CFT) regulators about the

¹¹ See http://www.fincen.gov/pdf/Financial%20Inst%20Outreach%20Init%20MSB_final.pdf

¹² See http://www.fincen.gov/news_room/rp/msb_exam_materials.html

challenges related to the regulation of money transmission and stored value, and found that there is a growing commitment to greater cooperation and information sharing.

Thank you for being a part of this important dialogue today.

###