
Sunrise Analysis: Money Transmitters

A Report to the
Governor
and the
Legislature of
the State of
Hawaii

Report No. 04-10
October 2004



THE AUDITOR
STATE OF HAWAII

The Office of the Auditor

The missions of the Office of the Auditor are assigned by the Hawaii State Constitution (Article VII, Section 10). The primary mission is to conduct post audits of the transactions, accounts, programs, and performance of public agencies. A supplemental mission is to conduct such other investigations and prepare such additional reports as may be directed by the Legislature.

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5. *Health insurance analyses* examine bills that propose to mandate certain health insurance benefits. Such bills cannot be enacted unless they are referred to the Office of the Auditor for an assessment of the social and financial impact of the proposed measure.
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OVERVIEW

Sunrise Analysis: Money Transmitters

Report No. 04-10, October 2004

Summary

We analyzed whether money transmitters should be regulated as proposed in House Bill No. 2428 (H.B. No. 2428) introduced in the 2004 legislative session. The Legislature specifically requested this analysis in House Concurrent Resolution No. 90, House Draft 1 (H.C.R. No. 90) of the 2004 legislative session.

Money transmitters are non-bank entities that transmit funds from one individual or institution to another, inside or outside the United States, by any means including wire, facsimile, or electronic transfer.

H.B. No. 2428 would amend the Hawaii Revised Statutes by adding a chapter known as the “Money Transmitters Registration Act.” The proposal would establish within the Department of Commerce and Consumer Affairs, Division of Financial Institutions, a registration program for money transmitters. H.B.No. 2428 and H.C.R. No. 90 suggest two potential threats to the public from unregulated money transmitters: (1) consumers of money transmission services may be harmed if their transmitted funds are never received or if a delay in the transmission of funds adversely affects the recipient and (2) the public, in general, may be harmed if the use of money transmitters facilitates crimes.

The Hawaii Regulatory Licensing Reform Act, Chapter 26H, HRS, states that professions and vocations should be regulated only when reasonably necessary to protect the health, safety, and welfare of consumers. We found that regulation of money transmitters is not warranted.

We found little *evidence* of harm to consumers or the public. Hawaii state agencies have few records of complaints against money transmitters, allegations of harm to consumers in Hawaii are largely anecdotal, and other states also lack evidence of harm to consumers.

Furthermore, we found little evidence of harm to the public from the use of money transmitters to further crimes. We did not find sufficient evidence indicating that use of money transmitters to facilitate crimes is a dangerous problem or of paramount concern to law enforcement officials. We also found that potential illegal activities involving a money transmitter are interstate or international, under federal jurisdiction and investigated by federal authorities. State law enforcement efforts coordinated with federal authorities would be more effective than additional state regulation.

We found that alternatives to state regulation, already in place, provide sufficient protections to the public and consumers. The federal government recently



expanded regulatory oversight of money transmitters. State and federal money laundering laws deter illegal use of money transmitters, and consumers are protected through market constraints.

Lastly, the proposed regulation provides few added benefits to consumers while costs to taxpayers and consumers are uncertain.

Recommendation and Response

We recommend that House Bill No. 2428 not be enacted.

The Department of Commerce and Consumer Affairs responded that our report was thorough and wide ranging, covering not only issues related to the direct consumers of money transmitter services, but also to the indirect impact of money transmitter activities on the public at large. However, the department disagrees with our conclusion and continues to believe that the interests of Hawaii's consumers and the public at large would be well served by the enactment of legislation to regulate the activities of money transmitters operating in Hawaii. Although not a formal participant of the review, the Department of the Attorney General opted to submit a response to the report, which echoed the Department of Commerce and Consumer Affairs' desire for regulation of money transmitters.

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Submitted by

THE AUDITOR
STATE OF HAWAII

Report No. 04-10
October 2004

Foreword

The Hawaii Regulatory Licensing Reform Act, Chapter 26H, Hawaii Revised Statutes, contains a “sunrise” provision requiring that measures proposing regulation of previously unregulated professions or vocations be referred to the State Auditor for analysis prior to enactment.

This report evaluates the regulation of money transmitters that was proposed in House Bill No. 2428 introduced in the 2004 legislative session. The Legislature requested this analysis in House Concurrent Resolution No. 90, House Draft 1 of the 2004 legislative session. The report presents our finding on whether the proposed regulation complies with policies in the licensing reform law and whether there is a reasonable need to regulate money transmitters to protect the health, safety, or welfare of the public.

We acknowledge the cooperation of the Department of Commerce and Consumer Affairs, Division of Financial Institutions, and other organizations and individuals knowledgeable about the occupation whom we contacted during the course of our analysis.

Marion M. Higa
State Auditor

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Chapter 1

Introduction

This report responds to a “sunrise” provision of the Hawaii Regulatory Licensing Reform Act—Chapter 26H, Hawaii Revised Statutes (HRS). The sunrise provision requires legislative bills that propose regulation of previously unregulated professions or vocations be referred to the State Auditor for analysis prior to enactment. The State Auditor is to assess whether the proposed regulation is necessary to protect the health, safety, or welfare of consumers and is consistent with other regulatory policies stated in the law. Also, the State Auditor is to set forth the probable effects of the proposed regulation and assess alternative forms of regulation.

The regulation of money transmitters is proposed in House Bill No. 2428 (H.B. No. 2428) of the 2004 legislative session. Money transmitters are non-bank entities that transmit funds from one individual or institution to another, inside or outside the United States, by any means including wire, facsimile, or electronic transfer. The Legislature specifically requested an analysis of this proposal in House Concurrent Resolution No. 90, House Draft 1 (H.C.R. No. 90), of the 2004 legislative session.

Background

Both national and local proponents of regulation express fears that money transmitters are being used for unlawful purposes, including money laundering of proceeds from the sale of illicit drugs and financing of terrorist activities. Recently, these fears have grown from media attention on the illegal drug trade and substance abuse and from reports that the September 11th hijackers used money transmitters to send and receive funds to finance their activities. In addition, some policymakers and industry officials argue there is a lack of consumer protection for lawful money transmitter users. To determine whether regulation of money transmitters is needed to provide greater protection for the public and consumers, the Legislature requested this sunrise analysis.

Money transmission businesses

Money transmission businesses are referred to as non-bank financial institutions or non-depository providers of financial services. Western Union and MoneyGram, the names most commonly associated with money transmission, are the dominant entities in national and international money transmission markets. In Hawaii, the market comprises Western Union and MoneyGram outlets as well as many other often small, ethnically-focused entities. Money transmitters are located throughout the state. Western Union has outlets in major grocery stores,

military exchanges, and discount stores; MoneyGram has outlets in payday advance businesses, check-cashing businesses, small neighborhood grocery stores, and service station convenience stores. Other locally-owned businesses unaffiliated with Western Union or MoneyGram are located in downtown Honolulu and in neighborhoods with large Filipino populations. In addition, travel agencies and postal service stores often provide money transmission services.

Money transmitters have a long history of serving immigrants, travelers in emergencies, and the “unbanked.” The unbanked are typically young, low-income workers who do not maintain a formal relationship with banks or depository institutions. The unbanked do not like dealing with banks and generally believe they would not write enough checks to warrant a bank account.

Federal and state money transmission regulations

Money transmitters in Hawaii are not currently subject to state regulations similar to those applicable to banks or other financial institutions. Recent amendments to regulations implementing the Bank Secrecy Act have, however, substantially increased federal requirements applicable to money transmitters.¹ Money transmitters are now required to register with and report suspicious transactions to the Department of the Treasury’s Financial Crimes Enforcement Network (FinCEN). A suspicious transaction is broadly defined as any transaction relevant to the possible violation of any law or regulation and specifically defined in the Code of Federal Regulations.² There are both civil and criminal penalties for noncompliance, including fines and imprisonment.

Other states’ money transmission regulations

Despite federal regulations, a majority of states require either registration or licensure of money transmitters. Most state statutes predate the expansion of federal regulations. As shown in Exhibit 1.1, forty states require licensing, two require registration, and eight states, including Hawaii, do not have any form of regulation of money transmitters.

In 1989, the Money Transmitters Regulatory Association, a national non-profit organization of state regulators, was formed. This organization was created to foster effective and efficient regulation of money transmitters and other money services businesses. The association drafted model legislative guidelines and made them available to states developing or modernizing their money transmission legislation.

The Money Laundering Suppression Act of 1994 recommended that states enact uniform laws to regulate money services businesses and that the Department of the Treasury promulgate regulations covering these businesses. The Money Transmitters Regulatory Association provided input to the development of the model Uniform Money Services Act.

Exhibit 1.1**State Regulation of Money Transmitters**

STATE/ JURISDICTION	TYPE OF REGULATION	STATE/ JURISDICTION	TYPE OF REGULATION
Alabama	Licensure	New Hampshire	None
Alaska	None	New Jersey	Licensure
Arizona	Licensure	New Mexico	None
Arkansas	None	New York	Licensure
California	Licensure	North Carolina	Licensure
Colorado	Licensure	North Dakota	None
Connecticut	Licensure	Ohio	Licensure
Delaware	Licensure	Oklahoma	Licensure
Florida	Licensure	Oregon	Licensure
Georgia	Registration	Pennsylvania	Licensure
Hawaii	None	Rhode Island	Licensure
Idaho	Licensure	South Carolina	None
Illinois	Licensure	South Dakota	Licensure
Indiana	Licensure	Tennessee	Licensure
Iowa	Licensure	Texas	Licensure
Kansas	Registration and bonding	Utah	Licensure
Kentucky	Licensure	Vermont	Licensure
Louisiana	Licensure	Virginia	Licensure
Maine	Licensure	Washington	Licensure
Maryland	Licensure	West Virginia	Licensure
Massachusetts	Licensure	Wisconsin	Licensure
Michigan	Licensure	Wyoming	Licensure
Minnesota	Licensure	In total, the number of states with:	
Mississippi	Licensure	Licensure = 40	
Missouri	Licensure	Registration = 2	
Montana	None	No regulation = 8 (including Hawaii)	
Nebraska	Licensure		
Nevada	Licensure		

Source: State banking regulatory agencies and websites.

A template state safety and soundness law drafted by the National Conference of Commissioners on Uniform State Laws, the model act creates licensing provisions for various types of money services businesses. The Uniform Money Services Act is intended to create a level playing field for new entrants into markets in different states and facilitate compliance with multiple state requirements in a uniform and cost-effective manner.

Professional associations for money transmitters

The money transmitter industry itself formed an association in 1999 called the National Money Transmitters Association. The association promotes the interests of money transmitters and strives to improve their image. Activities include informational conferences on laws, regulations and compliance requirements. The association meets with legislators, regulators, and law enforcement officials to promote a better understanding of money transmitter services and has developed “best practices papers” to aid money transmitters with legal and regulatory compliance issues. The National Money Transmitters Association also participates in developing and modifying legislation and regulations affecting the industry and serves as a central source of information.

Proposal to regulate money transmitters

The regulatory proposal that we were asked to analyze, H.B. No. 2428 of the 2004 legislative session, would amend the Hawaii Revised Statutes by adding a chapter known as the “Money Transmitters Registration Act.” The proposal would establish within the Department of Commerce and Consumer Affairs, Division of Financial Institutions, a registration program for money transmitters.

Purpose of the bill

H.B. No. 2428 was an administration bill introduced in response to the attention money transmitters have received since the September 2001 terrorist attacks in the United States. The administration intends the proposed registration to be a first step toward a more comprehensive regulatory framework. H.C.R. No. 90, which requested this sunrise analysis, asserts that regulation may make it less likely money transmitters will be used to further unlawful ends and will offer greater consumer protection.

Registration program

The legislative proposal would require money transmitters to register annually with the Division of Financial Institutions and maintain an office within the state. The proposed program would allow authorized delegates to provide money transmission services on behalf of the registrant. The bill proposes civil sanctions for unregistered activity and

specifies requirements on money laundering reporting, money transmission delivery timelines, receipts, refunds, and record keeping.

Exemptions

H.B. No. 2428 proposes numerous exemptions from registration, including any U.S. department, agency, or instrumentality; the U.S. Postal Service; any state, county, city, or other government department, agency, or instrumentality; banks; any board of trade; registered futures commission merchants; processing, clearance, or settlement services; securities broker-dealers; insurance companies; buyers and sellers of stored value or payment instruments; and attorneys in the course of their practice of law.

Objectives

The objectives of this analysis were to:

1. Determine whether there is a reasonable need to regulate money transmitters to protect the health, safety, or welfare of the public.
2. Assess the probable effects of regulation, specifically the effects on money transmitting businesses, those sending money and the recipients of those funds, and the criminal justice system.
3. Make recommendations, as appropriate, based on our findings.

Scope and Methodology

To assess the need to regulate money transmitters as proposed in H.B. No. 2428, we applied the regulation criteria set forth in Section 26H-2, HRS, of the Hawaii Regulatory Licensing Reform Act.

The Legislature established policies in Section 26H-2 to ensure that regulation of an occupation takes place only for the right reason: to protect consumers. Regulation is an exercise of the State's police power and should not be imposed lightly. Consumers rarely initiate regulation; more often, practitioners themselves request regulation for benefits that go beyond consumer protection. Practitioners often equate licensure with professional status in seeking respect for the occupation.

The policies set forth in Section 26H-2, amended by Act 45 of 1996, continue to reinforce consumer protection as the primary purpose of regulation:

- The State should regulate professions and vocations only where reasonably necessary to protect consumers;

- Regulation should protect the health, safety, and welfare of consumers and not the profession;
- Evidence of abuses should be given great weight in determining whether a reasonable need for regulation exists;
- Regulation should be avoided if it artificially increases the costs of goods and services to the consumer, unless the cost is exceeded by potential dangers to the consumer;
- Regulation should be eliminated when it has no further benefit to consumers;
- Regulation should not unreasonably restrict qualified persons from entering the profession; and
- Aggregate fees for regulation and licensure must not be less than the full costs of administering the program.

We were also guided by the publication *Questions a Legislator Should Ask*, published by the Council on Licensure, Enforcement and Regulation, a national organization.³ According to this publication, the primary guiding principle for legislators is whether the unregulated profession presents a clear and present danger to the public's health, safety, and welfare. If it does, regulation may be necessary; if not, regulation is unnecessary and wastes taxpayers' money.

We also used additional criteria for this analysis, including whether:

- The incidence or severity of harm based on documented evidence is sufficiently real or serious to warrant regulation;
- No alternatives provide sufficient protection to consumers (such as federal programs, other state laws, marketplace constraints, private action, or supervision); and
- Most other states regulate the occupation for the same reasons.

In assessing the need for regulation and the specific regulatory proposal, we placed the burden of proof on the administration and proponents to justify their request for regulation and defend the proposed legislation. We evaluated their arguments and data against the criteria stated above. We examined the regulatory proposal and determined whether the administration and proponents had made a strong enough case for regulation. It is not enough that regulation *may* have *some* benefits. We recommend regulation only if it is *demonstrably* necessary to protect the public.

We also scrutinized the language of the regulatory proposal for appropriateness. We determined whether the proposed legislation was one of three approaches to occupational regulation. The three approaches to occupational regulation, from the most restrictive to the least restrictive, are:

Licensing. A licensing law gives persons who meet certain qualifications the legal right to deliver services, that is, to practice the profession (for example, social work). Penalties may be imposed on those who practice without a license. To institute and monitor minimum standards of practice, licensing laws usually authorize a board that includes members of the profession to establish and implement rules and standards of practice.

Certification. A certification law restricts the use of certain titles (for example, social worker) to persons who meet certain qualifications, but does not bar others who do not use the title from offering such services. This restriction is sometimes called *title protection*. Government certification should not be confused with professional certification, or credentialing, by private organizations. For example, social workers may receive certification from the National Association of Social Workers.

Registration. A registration law simply involves practitioners enrolling with the State so that a roster or registry is created and to enable the State to keep track of practitioners. Registration may be mandatory or voluntary.

In addition to assessing the need for regulation and the specific legislative proposal, we considered the appropriateness of other regulatory alternatives. We also assessed the cost impact on the proposed regulatory agency and the regulated group.

To accomplish the objectives of our analysis, we reviewed literature on money transmitters and their regulation, including relevant federal regulation, regulation in other states, and Hawaii statutes and rules. We reviewed complaints filed at the Office of Consumer Protection and the Office of the Ombudsman and obtained information from local money transmitters and national organizations of money transmitters. We contacted local, state, and federal law enforcement agencies to determine the need for and potential impact of regulation. To identify the costs of regulation and determine the probable effects of regulation on consumers, the regulating agency, and the regulated group, we surveyed other state regulatory agencies.

We conducted our assessment from May 2004 to September 2004 in accordance with generally accepted government auditing standards.

Chapter 2

Regulation of Money Transmitters Is Not Warranted

This chapter presents the finding of our analysis of the regulation of money transmitters proposed in H.B. No. 2428 of the 2004 Regular Session. Money transmitters pose little risk of harm to consumers and the public. Some protections already exist, and regulation would likely benefit certain money transmitters more than consumers. We conclude that the bill should not be enacted.

Summary of Finding

Regulation of money transmitters is not warranted.

Regulation of Money Transmitters Is Not Warranted

Chapter 26H, HRS calls for regulation of professions and vocations only when necessary to protect the health, safety, and welfare of consumers. In assessing the need for regulation, evidence of abuses and harm must be given great weight and the benefits and costs of regulation to consumers be considered. H.C.R. No. 90 and H.B. No. 2428 suggest two potential threats to the public from unregulated money transmitters: (1) consumers of money transmission services may be harmed if their transmitted funds are never received or if a delay in the transmission of funds adversely affects the recipient and (2) the public, in general, may be harmed if the use of money transmitters furthers or facilitates crimes. We found scant evidence to prove that money transmitters pose a risk of serious harm to consumers or that the illegal use of money transmitters poses a risk of serious harm to the public. Moreover, other protections already exist, such as federal regulations, other Hawaii state laws, and marketplace constraints.

We also found that registration would have few benefits for consumers. And while the registration program is expected to have little cost, the administration makes clear that it envisions a higher level of regulation in the future. We found that licensure, as modeled after the Uniform Money Services Act, would have significant costs and would primarily benefit large money transmitters.

There is little evidence of harm to consumers

Section 26H-2, HRS, clearly states that regulation shall be undertaken only where reasonably necessary to protect the health, safety, and

welfare of consumers of the services. The concern for consumers of money transmitters, however, appeared secondary to the concern for the public in general in the registration proposal and the concurrent resolution requesting the sunrise analysis. To determine whether consumers are at risk, we requested information on any complaints against money transmitters from the Department of Commerce and Consumer Affairs, the Office of the Ombudsman, and the Better Business Bureau. The bureau did not respond to our query; the other two agencies reported very few consumer complaints. We also interviewed local money transmitter business owners, including those who testified on behalf of H.B. No. 2428. From them, we heard only general secondhand stories of harm, and were not given any leads to those with firsthand knowledge or specific details.

To broaden our scope of evidence, we surveyed financial institution regulatory agencies in other jurisdictions asking for evidence of harm to consumers in their respective jurisdictions. We received 26 survey responses out of 54.¹ The responses provided little support for regulation.

Overall, we found little or no documented evidence of sufficiently serious harm to warrant regulation.

There are few records of complaints in Hawaii

The Department of Commerce and Consumer Affairs, Division of Financial Institutions, has no record of a disgruntled customer wanting to file a formal complaint. Records of the Department of Commerce and Consumer Affairs, Office of Consumer Protection reveal two complaints against Western Union since 1989. One complaint involved release of transferred funds to the wrong person; the other involved release of transferred funds without the required password. The Office of the Ombudsman has no record of any complaints against money transmitters. We requested information from the Better Business Bureau, but received no response. In total, state agencies have little evidence of harm to consumers of money transmitter services.

Allegations of harm to consumers in Hawaii are largely anecdotal

In interviews, owners of money transmitter businesses related anecdotes of harm, but proffered no hard evidence. We spoke with representatives of money transmitters who presented written testimony in support of H.B. No. 2428 or its companion bill S.B. No. 2903. One representative stated in testimony that customers have been wronged, but when interviewed, could recall only general anecdotes of harm. According to his account, customers had asserted that when using another company,

the funds sent were never received. Other transmitters interviewed had not heard similar anecdotes, although two noted they had heard of transmissions taking longer than expected.

Other states also lack evidence of harm to consumers

The Division of Financial Institutions suggested that, in Hawaii, assessing harm to consumers may be difficult without a government agency designated to handle complaints against money transmitters. We, accordingly, turned to other jurisdictions to gauge their experiences with such complaints.

In our survey of financial institution regulatory agencies in other jurisdictions, we sought information on their experiences with regulation, illegal activities, and complaints. Of the 26 respondents, 21 of which regulate money transmitters, only Colorado provided evidence of complaints received from customers. The Colorado Department of Regulatory Agencies recently conducted a sunset review of the regulation of money transmitters. The review reported that in a five-year period, the Colorado Division of Banking received only eight complaints. It noted that cultural and language barriers may prevent customers from presenting complaints to government authorities.

In summary, we found limited evidence of complaints, in Hawaii as well as in other jurisdictions. As the Colorado sunset review suggests, cultural and language barriers may prevent consumers from reporting complaints. Accordingly, we conclude that the proposed regulatory mechanism for recourse would be unnecessary or would likely be ineffective.

There is little evidence of harm to the public from the use of money transmitters to further crimes

We did not find sufficient evidence indicating that use of money transmitters to facilitate crimes is a dangerous problem or of paramount concern to law enforcement officials. The sale of illegal drugs within the state is under state jurisdiction. Nevertheless, we found that the transmission of proceeds from the sale of illegal drugs, or the laundering of those proceeds, is almost exclusively interstate or international and, therefore, under federal jurisdiction. These criminal activities are more appropriately combated with federal laws, rules, and regulations. We conclude that state law enforcement efforts coordinated with federal authorities would be more effective than new state regulation as a tool to fight the interstate or international element of crimes.

Illegal activity involving money transmitters in Hawaii appears to be minimal

Local law enforcement officials we interviewed did not convey much concern over the use of money transmitters in conjunction with illegal

activities. They could not recall specific cases of money transmitters used to further crimes, nor did they follow up on our inquiries with evidence of specific cases. An officer remembered use of money transmitters to move money derived from prostitution; another recalled use of money transmitters to send money as payment for a product or service that was never received.

Similar complaints of fraud have been filed with the Department of Commerce and Consumer Affairs' Office of Consumer Protection. It is, however, unclear that state regulation of money transmitters could effectively stem such criminal activity. The police officer interviewed suggested that regulations requiring identification of fund recipients may help prevent these crimes; however, requiring recipient identification in other states is beyond the jurisdiction of the State of Hawaii.

The U.S. Attorney's Office has evidence that Western Union agents have been used in interstate and international transfers of proceeds from illegal drug trafficking. The office added, however, that Western Union has been very helpful in the identification and prosecution of criminals. In addition, representatives of both the Honolulu Police Department and the U.S. Attorney's Office have observed that the majority of illegal drug trafficking moneys are carried by individuals to avoid unnecessary attention.

In our survey, we asked other jurisdictions for evidence of illegal activity involving money transmitters. Twenty-one of 26 respondents did not provide any specific evidence that money transmitters have been used to further unlawful activity.

Illegal money transmissions are interstate and under federal jurisdiction

Hawaii is a small island state with only one major metropolitan area and large immigrant populations. As a result, the vast majority of money transfers through a Hawaii transmitter are interstate or international. A number of money transmitters stated that they had never transmitted funds within the state, and many transmit funds exclusively to the Philippines. Use of money transmitters to transfer illicit funds within the state would apparently be extremely infrequent.

Illegal activities that involve interstate or international transactions are under federal jurisdiction and are investigated by federal authorities, such as FinCEN, the Federal Bureau of Investigations, the Internal Revenue Service, the U.S. Customs Service, the Drug Enforcement Agency, and the U.S. Attorney's Office. State law enforcement efforts coordinated with federal authorities would be more effective than additional state regulation. Results from our survey of other jurisdictions

support this conclusion. All of the illegal activities involving money transmitters reported to us were interstate or international and investigated by federal law enforcement agencies.

***Other protections exist,
making regulation
unnecessary***

We found that alternatives to state regulation, already in place, provide sufficient protections to the public and consumers. The public is protected through recently increased federal regulations and other Hawaii state and federal laws. In addition, consumers are protected through market constraints.

The federal government recently expanded regulatory oversight of money transmitters

The proposed state registration scheme would create duplicative filing and reporting requirements, wasting resources of both money transmitter businesses and the State. Proponents of H.B. No. 2428 argue that registration with the State would be helpful to law enforcement officials because a registry would provide them with a list of money transmitters currently operating in Hawaii. Since January 2002, however, money transmitters have been required to register with FinCEN. A list of registered transmitters is readily available on the Internet. As of July 2004, 53 Hawaii money transmitters were registered.

The federal government has also increased its scrutiny of bank and non-bank currency transactions in conjunction with the war on terror and on illegal drugs. Recent amendments to regulations implementing the Bank Secrecy Act have increased federal requirements applicable to money transmitters.² As noted, money transmitters must not only register with FinCEN, but must also report suspicious transactions to FinCEN. Suspicious transactions include any transaction relevant to the possible violation of any law or regulation and other transactions as required by the Code of Federal Regulations.³ There are both civil and criminal penalties for noncompliance, including fines and imprisonment.

Federal regulators support coordinated law enforcement and compliance efforts and offer assistance to all law enforcement agencies and money transmitter businesses. Suspicious activity reports filed with FinCEN are readily available to Hawaii state and local law enforcement agencies. FinCEN also provides free reporting compliance materials to money transmitters. Available information includes a money laundering prevention guide, quick reference guides for compliance with reporting suspicious activities, posters to educate customers on a money transmitter's need for personal information (bilingual versions available), reporting and recordkeeping training videos and interactive CD-ROM, and "take one" cards informing customers about new reporting requirements.

Most state regulatory statutes predate the expansion of federal regulatory requirements

In our sunrise analysis, we do consider the prevalence of regulation of an occupation by other states. Indeed, 42 of the 50 states do regulate money transmitters, although only 15 states besides Hawaii require sunrise analyses of proposed regulations. Based on our survey results and a review of state statutes, we conclude most state laws on regulation of money transmitters, however, predate the expansion of federal regulatory requirements.

State and federal money laundering laws deter illegal use of money transmitters

Chapter 708A, HRS, known as the Hawaii “Money Laundering Act” provides that it is a felony to knowingly transmit proceeds from unlawful activities with the intent to promote the unlawful activity, to conceal the proceeds, or to avoid a reporting requirement under state or federal law. Penalties for these crimes can be up to ten years’ imprisonment and substantial fines.

In addition, United States Code, Title 18, Section 1956 provides that whoever transmits or attempts to transmit funds interstate or internationally with the intent to promote an unlawful activity, to conceal the proceeds, or to avoid a state or federal reporting requirement shall be punished by imprisonment for not more than 20 years and subject to a fine. Monetary transactions include the transfer of funds through money transmitters.

Proponents of the registration proposal argue that registration may deter a money transmitter from knowingly transmitting funds derived from criminal activity. We find it a tenuous argument that a money transmitter who would willingly take the risk of participating in an illegal activity, which carries significant criminal penalties, would cease that activity rather than take the risk of operating as an unregistered money transmitter, which carries very little penalty. Indeed, the criminal laws already in place are much greater deterrents to illegal use than any regulatory requirement.

Consumers are protected through market constraints

The market for money transmission services is competitive. Competitive market forces will ensure companies provide services that meet customer demands more efficiently than government regulations. Western Union and MoneyGram are fierce competitors, with a majority of money transmission transactions moving through these two dominant companies. Both have well-developed policies and procedures aimed at

providing customer satisfaction and protection. In addition, local money transmitters with niche markets to the Philippines depend almost entirely on regular customers and referrals for new customers; such reliance necessitates a commitment to quality of service.

The proposed regulation provides few added benefits for consumers, and costs to regulators and consumers are uncertain

In addition to offering little needed consumer protection, the proposed regulation provides few added benefits for consumers. The proposed record keeping requirements are unnecessary, as best business practices already recommend record retention for potential tax auditing purposes. Receipt requirements and transaction disclosures are regulated by the competitive market. If customers desire a receipt and written disclosure of transaction details—for example, the exchange rate that applies—they will seek transmitters that offer such services. Transmitters interviewed stated that they already disclose applicable exchange rates and that such information is contained on the sending customer’s receipt.

Furthermore, according to the administration’s justification for the proposed legislation, the Division of Financial Institutions does not intend to enforce the record keeping, receipt, and transaction disclosure requirements. Requirements that are not enforced offer no reliable benefit to consumers. The administration envisions a higher level of regulation for money transmitters in the future and, in testimony presented on behalf of H.C.R. No. 90, the commissioner of the Division of Financial Institutions directly proposed to develop legislation modeled on the Uniform Money Services Act.

The Uniform Money Services Act was drafted at the recommendation of Congress in the Money Laundering Suppression Act of 1994. Since that time, also as recommended by Congress, the Department of the Treasury has promulgated regulations covering money services businesses, including money transmitters. The Uniform Money Services Act specifies the highest level of regulation (licensing) with very detailed requirements, including surety bond requirements and net worth requirements. The uniform act suggests a nonrefundable application fee of \$2,000 and a license fee of \$2,000. For states that have licensure, the actual application and license fees vary; for example, Minnesota has a \$4,000 application fee and a \$2,500 annual renewal fee, while Nebraska recently increased its application fee from \$100 to \$1,000 and its annual renewal fee from \$100 to \$250.

From our survey of other jurisdictions, some with licensing programs estimate the cost of regulation to be at least \$100,000 per year. A licensing program can potentially cost both licensees and state government significant sums, and can also be costly to consumers, both in fees charged and time spent (if nearby neighborhood businesses that cannot meet net worth and surety bond requirements are driven out of the

market). We also found that the uniform act would give considerable discretion to the Department of Commerce and Consumer Affairs, Hawaii's regulatory agency. For example, the Department of Commerce and Consumer Affairs would have the authority to determine fitness of the licensee based upon, among other things, business experience and character. The criteria for these determinations, however, are not explicit.

Conclusion

For the reasons stated above, we conclude that money transmitters should not be regulated as proposed in H.B. No. 2428.

Recommendation

We recommend that H.B. No. 2428 not be enacted.

Notes

Chapter 1

1. See Code of Federal Regulations, Title 31, Part 103.
2. Ibid.
3. Benjamin Shimberg and Doug Roederer, *Questions a Legislator Should Ask, Second Edition*, The Council on Licensure, Enforcement and Regulation, Lexington, Kentucky, 1994.

Chapter 2

1. We sent a total of 54 surveys to: the 50 states, the District of Columbia, Guam, Puerto Rico and the Virgin Islands.
2. See Code of Federal Regulations, Title 31, Part 103.
3. Ibid.

Response of the Affected Agency

Comments on Agency Response

We submitted a draft copy of this report to the Department of Commerce and Consumer Affairs on September 24, 2004. A copy of the transmittal letter to the department is included as Attachment 1. The department's response is included as Attachment 2. Although not a formal participant of the review, the Department of the Attorney General opted to submit a response to the report, which is included as Attachment 3.

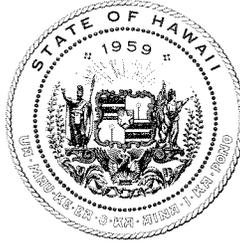
The Department of Commerce and Consumer Affairs responded that our report was thorough and wide ranging, covering not only issues related to the direct consumers of money transmitters, but also to the indirect impact of money transmitter activities on the public at large. However, the department disagrees with our conclusion and continues to believe that the interests of Hawaii's consumers and the public at large would be well served by enactment of legislation to regulate the activities of money transmitters operating in Hawaii. The Department of the Attorney General echoed the Department of Commerce and Consumer Affairs' desire for regulation of money transmitters.

The Department of Commerce and Consumer Affairs states that our conclusion as to the need for regulation for law enforcement purposes is contrary to the opinion of state and federal law officials who testified on behalf of the bill and who continue to support its passage. However, our fieldwork, which included interviews with these and other individuals, did not yield us any significant *evidence* of harm. Indications of the potential for harm were largely speculative and the few complaints that were identified were largely anecdotal in nature and lacking specific detail.

We note that the Legislature established policies in Section 26H-2, Hawaii Revised Statutes (HRS), to ensure that regulation of an occupation takes place only for the right reason: to protect consumers. Regulation is an exercise of the State's police power and should not be imposed lightly. Section 26H-2, HRS, lists specific criteria for us to consider when determining whether a profession should be regulated, one of which is that evidence of abuses should be given great weight in determining whether a reasonable need for regulation exists. Given that we could not identify such evidence, we stand by our conclusion that money transmitter regulation in Hawaii is not warranted.

ATTACHMENT 1

STATE OF HAWAII
OFFICE OF THE AUDITOR
465 S. King Street, Room 500
Honolulu, Hawaii 96813-2917



MARION M. HIGA
State Auditor
(808) 587-0800
FAX: (808) 587-0830

September 24, 2004

COPY

The Honorable Mark E. Recktenwald
Director
Department of Commerce and Consumer Affairs
King Kalakaua Building
335 Merchant Street
Honolulu, Hawaii 96813

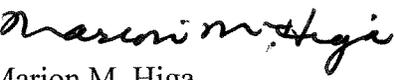
Dear Mr. Recktenwald:

Enclosed for your information are three copies, numbered 6 to 8 of our confidential draft report, *Sunrise Analysis: Money Transmitters*. We ask that you telephone us by Tuesday, September 28, 2004, on whether or not you intend to comment on our recommendations. If you wish your comments to be included in the report, please submit them no later than Monday, October 4, 2004.

The Governor, and presiding officers of the two houses of the Legislature have also been provided copies of this confidential draft report.

Since this report is not in final form and changes may be made to it, access to the report should be restricted to those assisting you in preparing your response. Public release of the report will be made solely by our office and only after the report is published in its final form.

Sincerely,


Marion M. Higa
State Auditor

Enclosures

LINDA LINGLE
GOVERNOR
JAMES R. AIONA, JR.
LT. GOVERNOR



STATE OF HAWAII
OFFICE OF THE DIRECTOR
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS
335 MERCHANT STREET
P.O. BOX 541
HONOLULU, HAWAII 96809

MARK E. RECKTENWALD
DIRECTOR
LAWRENCE M. REIFURTH
DEPUTY DIRECTOR

October 4, 2004

RECEIVED

OCT 4 4 25 PM '04

OFFICE OF THE AUDITOR
STATE OF HAWAII

Ms. Marion M. Higa
State Auditor
Office of the Auditor
465 South King Street, Room 500
Honolulu, Hawaii 96813

Re **Draft Report Entitled *Sunrise Analysis: Money Transmitters***

Dear Ms. Higa:

Thank you for the opportunity to comment on the draft report entitled *Sunrise Analysis: Money Transmitters* ("Report"). The State of Hawaii, Department of Commerce and Consumer Affairs ("Department") and its Division of Financial Institutions ("DFI") continue to believe that the interests of Hawaii's consumers and the public at large would be well served by enactment of legislation to regulate the activities of money transmitters operating in Hawaii.

House Bill No. 2428 ("HB No. 2428") proposed the regulation of money transmitters by DFI. House Concurrent Resolution No. 90, House Draft 1 ("HCR No. 90"), requested the State Auditor to assess the necessity of this proposed regulation. The Report concludes that regulation of money transmitters is not warranted essentially because:

- "scant evidence" was found that money transmitters pose a risk of serious harm to consumers;
- "scant evidence" was found that illegal use of money transmitters pose a risk of serious harm to the public;
- regulation would have "few benefits for consumers;" and
- other protections already exist, such as federal regulations, other Hawaii state laws, and marketplace constraints.

Ms. Marion M. Higa
October 4, 2004
Page 2

The Report was thorough and wide ranging, covering not only issues related to the direct consumers of money transmitter services, but also to the indirect impact of money transmitter activities on the public at large. We appreciate your office's hard work and attention to detail in considering the issues raised by the proposal.

Unregulated Money Transmission Poses a Serious Threat of Harm to the Public and to Consumers and its Alleviation Will Benefit Both

H.B. No. 2428 had two foci: law enforcement and consumer protection. The Report concludes that there is insufficient evidence of need for either in the field of money transmission.

The Report's conclusion as to the need for law enforcement is contrary to the opinion of state and federal law enforcement officials who testified on behalf of the bill and who continue to support its passage. According to the Department of the Attorney General, state regulation of money transmitters would provide a valuable tool in the law enforcement arsenal, would effectively coordinate with law enforcement efforts, and would ease investigation and prosecution of drug crimes.

As to consumer protection, the Report concludes that there is little evidence of harm to consumers from the use of money transmitters. The Auditor is correct in her observation that consumers have not complained significantly about money transmission services. Furthermore, her findings that cultural or language barriers may prevent consumers from presenting complaints to government authorities are consistent with what DFI learned in its discussions with other state agencies and field visits with money transmitters and their customers.

That agreement notwithstanding, the Department does not agree with the conclusion that because very few consumer complaints were reported, or because cultural or language barriers may discourage consumers from complaining to government authorities, state regulation of money transmitters is unnecessary or ineffective. In fact, it is for those very reasons that consumer oriented, local – as opposed to federal – regulation of the Hawaii money transmitter industry is crucial. Consumers will benefit from a system that will ensure that money transmission services are delivered in an honest and fair manner and will, furthermore, afford a forum for consumers to report dishonest and unfair practices with the reasonable expectation that their reports will be understood and acted upon.

Existing Protections are Inadequate

The Report concludes that other protections exist, “making regulation unnecessary.” Specifically, the public is said to be protected through recently increased federal regulation and other Hawaii state and federal laws, in addition to market constraints. Again, this conclusion runs contrary to that of state law enforcement officials. The existing protections are not adequate.

The federal laws to which the Report refers are primarily promulgated by the Treasury Department’s Financial Crimes Enforcement Network (“FinCEN”). FinCEN, however, is focused on administration of the national Bank Secrecy Act and, hence, focuses its attention on large, high profile institutions and occurrences. FinCEN’s scrutiny has not been directed to the smaller-scale illegal money transmission activities that are conducted in support of the drug trade. It is precisely because FinCEN has not focused its attention on local money transmission activities that states continue to step into the breach with their own programs.

The Report further concludes that existing state and federal money laundering laws already deter the illegal use of money transmitters, and that additional regulation is therefore unnecessary. The Report argues that a money transmitter who is already violating money laundering laws is unlikely to be deterred by the prospect of operating as an unregistered money transmitter. The point of the proposal, however, is not to criminalize money laundering a second time. That would, indeed, be unproductive. Instead, the point is to collect information by means of the registration program. The additional oversight, the extra pair of eyes, tells the money launderers that there are more people watching, and thereby acts as a deterrent.

Conclusion

The U.S. Senate does not believe that current efforts to address money laundering are sufficient, and has asked for increased state help in combating the problem.

According to Sen. Carl Levin (D., Mich), whose Permanent Subcommittee on Investigations has worked since the mid-1990’s to expose money laundering in the U.S. financial system, “Our continuing review of these matters shows that few parties have taken to heart the lessons of the past – not the bank regulators, not the state regulators and not the banks.” Wall Street Journal, October 1, 2004.

Ms. Marion M. Higa
October 4, 2004
Page 4

For these and the reasons expressed above, the Department believes that the state regulation of money transmitters, incorporating provisions similar to those proposed in HB No. 2428, would serve to protect consumers and the public at large more effectively than existing federal programs, state statutes and competitive market forces, and we therefore continue to recommend its adoption.

Again, we appreciate the opportunity to comment on your draft report.

Sincerely,



Mark E. Recktenwald
Director

MER:kk

cc: D. B. Griffin III

04-1004-Ltr to M. Higa-F

LINDA LINGLE
GOVERNOR



MARK J. BENNETT
ATTORNEY GENERAL

RICHARD T. BISSEN, JR.
FIRST DEPUTY ATTORNEY GENERAL

STATE OF HAWAII
DEPARTMENT OF THE ATTORNEY GENERAL
CRIMINAL JUSTICE DIVISION
425 QUEEN STREET
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(808) 586-1160
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October 1, 2004

Ms. Marion M. Higa, State Auditor
Office of the Auditor
Kekuanao'a Building
465 S. King Street, Room #500
Honolulu, Hawaii 96813-2917

RECEIVED
Oct 4 11 08 AM '04
OFFICE OF THE AUDITOR
STATE OF HAWAII

Re: Office of the Auditor's Sunrise Analysis: Money Transmitters

Dear Ms. Higa,

The Department of the Attorney General continues to support the intent and purpose of House Bill 2428 of the 2004 legislative session.

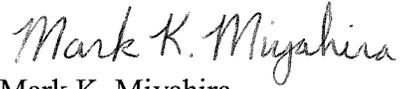
This bill would establish a system of registration of money transmitters to help ensure that these businesses are used for lawful purposes and promote protection for the public and consumers.

This bill would also assist law enforcement officials in enforcing money laundering laws. While Hawaii has an excellent money laundering statute, state laws could be made more effective by implementing the registration apparatus that would be created by this bill. If money transmitters are required to register, we believe that registration will deter individuals, engaged in illegal money laundering operations, from entering into the money transmitting business, and those who are not deterred will be more easily identified, caught and prosecuted.

The Department believes that there is a reasonable need to regulate money transmitters, through a registration program, in order to protect the welfare of the public. While the federal government has recently expanded regulatory oversight of money transmitters, the federal government does not possess the resources to investigate and prosecute every money transmitter who is in non-compliance. Based on their limited resources, federal prosecutions normally focus on big cases that have wide spread consequences. State registration of money transmitters will allow the State to fill in the gaps so that the smaller businesses, conducting illegal activities, do not escape detection.

While the State Auditor reports that there are few records of complaints, the Department believes that the State needs to be proactive rather than reactive in dealing with illegal activity that may be conducted through money transmitting businesses. The Department believes that the registration program will help to deter money laundering among money transmitters which will raise the standards of the money transmitting business thereby protecting the welfare of the public.

Very truly yours,

A handwritten signature in cursive script that reads "Mark K. Miyahira".

Mark K. Miyahira
Deputy Attorney General