Banks and MSBs

Will You Still Love Me Tomorrow?

BY SCOTT MCCLAIN, ESQ.

The banking situation for check cashers and money transmitters continues to be uncertain. Are we making progress on the bank discontinuance problem? What efforts are FiSCA and others making on the issue? Will your banker still love you tomorrow? (Apologies to the Shirelles.) FiSCA takes a look.

THE CURRENT SITUATION

Before 2000, there were few problems between money services businesses (MSBs) and the banks that served them. Although the industry has always been somewhat misunderstood by traditional bankers, our relationship with our depositories was a relatively happy one. Check cashers and money transmitters were just other types of commercial customers routinely served by depositories. The events of 9/11, the enactment of the USA Patriot Act and the resulting increased scrutiny by federal bank regulators changed all of that. Our businesses were deemed unacceptable risks, and the term MSB developed the effect of a Scarlet Letter within the banking industry; once branded, you could expect to get dumped. Many, many solid and respectable check cashers and licensed remitters have been thrown out of their banks and rejected out of hand by other depositories. Very few MSBs have been unaffected.

The financial services and banking industries agree that the account terminations problem stems largely from a perception among federal bank regulators that MSBs are high-risk accounts. Due to these pressures, banks are required to direct more and more resources toward internal compliance systems and monitoring their MSB customer activities. As a result of increased costs and regulatory exposure, some banks have simply decided to invest their resources in more profitable areas. In some cases, banks have terminated check cashers or money transmitters because of direct "suggestions" from field-level bank examiners. Other terminations have been due to vague "reputational risk" concerns or due to highly publicized multimillion dollar penalties assessed against other banks, totally unrelated to any activities by MSB customers.

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The underlying contention that check cashers are "high risk" is largely misguided. In 2006, the IRS examined about 6,000 companies, with only a handful being referred for penalty assessment. While the industry is not without its blemishes, the high-risk moniker simply does not accurately reflect the industry.

Michael Lynch, Vice President and Manager of Banco Popular's money services division, agrees. "I find that regulators' perception of Financial Service Centers as being 'high-risk' businesses is a misperception. Once I sit down with the regulator and review with them what I'm looking at, they are satisfied. It is also a very 'regular' business, which is to say that the same types of checks are cashed at the same times of the month, making it easy to identify irregularities."

Unfortunately, regulatory measures to address the problem have not been successful. In April 2005, in response to pressure from FiSCA and other industry leaders, FinCEN and the federal bank regulatory agencies released joint "MSB Guidance" on banking MSBs. The MSB Guidance was intended to relieve the banking crisis by enlightening bankers and MSBs on what steps they needed to take to comply with regulatory requirements. Nearly two years later, however, it is clear that the MSB Guidance has not alleviated the problem, and in some respects may have exacerbated the situation. Some banks have viewed the MSB Guidance as further adding to the regulatory burden.

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Terminations have continued, and not one single large bank that previously terminated its MSBs has resumed servicing the industry.

Alonzo Primus, who was recently promoted to President of First Bank of Delaware, agrees that additional regulatory guidance will not be a remedy. "We believe that even with the expected updated Interagency Guidance to be released by FinCEN, banks will continue to exit or choose not to offer traditional depository services to MSBs. Many see the costs incurred in the back office as an added expense that ultimately drives down the profitability of this type of program."

Although federal officials candidly acknowledge the extent and seriousness of the banking situation, even now, no formal regulatory solution has been offered. FiSCA General Counsel Gerald Goldman summed it up in his recent testimony before a Congressional Subcommittee:

"We conclude that all efforts at regulatory change have failed and will continue to fail and will not solve this problem. Regulation is not the answer. Its effort is hopelessly mired in a bureaucratic maze. We believe that it is time for legislative intervention before more real damage is done."

In short, the bank discontinuance solution is not going to come from regulators — it is going to come from us. FiSCA and others within the industry have been working diligently to turn the tide, and real progress is being made. Although we are still in the midst of a serious problem, at this point there is now a national dialogue on the issue. Our industry is now garnering support from key members of Congress, regulators and banking representatives. People are starting to agree that federal legislation is needed.

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Based on prior efforts and testimony before a House Financial Services subcommittee, Representatives Spencer Bachus, Carolyn Maloney, and other important legislators have expressed a strong interest in federal legislation intended to alleviate the current MSB crisis. Importantly, the American Bankers Association and others within the banking community have also expressed the need for a legislative approach, and have indicated their desire to work with FiSCA and the MSB industry to achieve a lasting solution.

REDUCING THE REGULATORY OVERLOAD

On October 26, 2006, FiSCA organized a groundbreaking meeting of MSB industry leaders in Washington, D.C., including national and regional money transmitters. The purpose of the meeting was to explore possible legislative solutions to the banking problem, including formation of an "MSB Coalition" to focus the combined efforts of all sectors of the financial services industry. As a result of these discussions, the MSB industry is for the first time positioned to leverage its combined political strength on this issue.

The MSB Coalition will be made up of representatives from all segments of the MSB community, including the check-cashing industry (FiSCA), money transmitters, money order processors, bill payment companies, and others with interests in the MSB community. One of the major short-term goals will be to reach out to all members of the MSB community, as well as key federal and state regulatory bodies, in an effort to increase awareness and encourage participation in solutions on this issue.

The main component of the MSB Coalition strategy is to introduce new federal laws designed to relieve our banks of much of the regulatory burdens in servicing MSBs. Banks are not required to monitor the compliance programs of their other customers, only their MSBs. This forces banks to act as the "functional regulators" of their financial services customers, which is a role they do not want to play.

The bill that is being proposed by the Coalition addresses this problem by creating a process that relieves banks of the requirement that they review and monitor the BSA compliance programs of their MSB customers. This involves a new "self-certification" procedure where an MSB would provide basic compliance information to its bank (i.e., proof of federal MSB registration and state licensing) and would then "certify" that it is in compliance and maintains an appropriate anti-money laundering program. An MSB that misrepresents its compliance status would be subject to penalties. This type of "self-certification" process borrows from similar regulations already in place under the Bank Secrecy Act designed to ensure that banks do not maintain accounts in the U.S. on behalf of high-risk, foreign "shell" banks.

There is a great amount of interest in the proposed legislation, and momentum is building. As the result of previous efforts, FiSCA and many other MSB Coalition members have already established important relationships with key members of Congress and other important allies. Additionally, FiSCA is working with representatives of the American Bankers Association, which also supports introduction of legislation to remedy the current MSB banking situation. Many individual money transmitters have likewise developed strong relationships with their legislators and regulators. Working with existing allies and developing additional grassroots support will be critical to the success of the MSB Coalition bill.

BANKING RELATIONS

Although the list of banks that serve MSBs continues to shrink, a number of savvy bankers are taking on some of these customers. Fortunately, there are a fair number of federal and state chartered depositories that remain comfortable serving the check-cashing industry. Several prominent banks, including Corus Bank, Banco Popular, North Fork Bank, Wachovia and Wells Fargo, to name a few, either specialize or have departments specializing in servicing these customers. A number of banks continue to serve money transmitters. For remitters, however, the situation remains more tenuous. There seem to be fewer banks willing, or able, to take on money transmitter accounts, and their criteria for accepting new accounts are quite strict. With respect to both remitters and check cashers, the options are on the decline.

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Nevertheless, in some regions, a number of depositories, including community banks and credit unions, are seizing lucrative opportunities in banking check cashers and licensed money remitters. These typically smaller players generally limit their activities to one area, and in some cases limit their MSB customers to a few "hand-picked" companies.

It is said that the Chinese character for "crisis" is made up of elements signifying "danger" and "opportunity." For some bankers, the MSB bank discontinuance problem has led to opportunities. What do these institutions have in common? They have the ability to critically evaluate their customers and understand that "MSB" does not equal "high risk." They have the flexibility and capacity to specialize in this market area; they understand the industry; and they know their customers. An encouraging number of depositories are realizing that the perceived risks of banking MSBs can be efficiently mitigated through application of appropriate BSA compliance programs and rule-based exception reporting.

Terrence W. Keenan, Senior Vice President with Corus Bank, agrees that bank discontinuance "is creating opportunities" for them. "Many banks just don't want to take on the increased expense and risk associated with compliance issues. On the other hand, we made a commitment to service check cashers, to do it right, and we believe we have."

TRADITIONAL 'MOM & POP' LOCATIONS ARE GOING TO BE FORCED TO OFFER ANCILLARY SERVICES TO OFFSET SOME DECLINE IN CHECK-CASHING VOLUME.

Other exciting options are on the horizon. Surprisingly, bankers might soon see competition for MSBs coming from within the MSB industry itself. In response to continuing pressures to find and keep accounts, a group of visionary money remitters, check cashers and bankers recently organized to seek FDIC and New York State charter approval to form a community bank specializing in serving the industry. First MSB Bank (in formation) will specialize in serving the unique needs of the licensed money remitters and check cashers, in addition to providing traditional community banking services and products. The bank concept is a sophisticated organization built from the ground up around innovative compliance solutions. The MSB bank will also bring to bear both state-of-the-art banking technology and solid executive leadership from experienced individuals in the industry. As they say, this idea really has some "legs" and is long overdue.

HOPE FOR CHECK 21?

Other banking solutions are emerging. Imagine clearing your checks through a community bank located 1,000 miles away! With the advent of check imaging and electronic payments technology, coupled with recently enacted enabling legislation, the opportunity exists for check cashers and other MSBs to electronically transmit checks for remote deposit. This technology also has the potential to alleviate some of the present banking problems.

The Check Clearing for the 21st Century Act (Check 21) became effective October 28, 2004, and we are now just beginning to see its potential for the check-cashing

industry. Developed by the Federal Reserve Board, Check 21 is designed to facilitate check truncation and to improve the overall efficiency of the nation's payments system. Under Check 21, virtually all checks (approximately 40 billion annually) may be converted from paper into electronic transmissions for processing. There are a number of emerging methods and check processing companies offering Check 21 systems. A growing number of financial institutions and retailers are incorporating the technology into their operations.

Richard Riese, Director of the Center for Regulatory Compliance at the American Bankers Association, predicted at our October FiSCA Conference that 2007 will be a big year for Check 21 solutions, and that we are likely to see greater numbers of depositories embracing the technology.

What Check 21 promises for the check-cashing industry is the ability to scan checks (either at point of sale or back office) for electronic deposit and clearing, as well as the ability to bank remotely with a depository many miles away. In areas where MSB-friendly banks are scarce, this is obviously a big plus. Some of the other reported benefits are reduced processing fees, accelerated items clearing, improved funds availability, and faster return on unpaid and exception items. Some banks and check processing companies are just beginning to offer Check 21 programs for their check casher customers. Feedback on these systems, as they start to come online, has been mixed.

James Wells, an electronic payments expert with Wellspring Consulting International, Inc., reports many satisfied users. "In speaking with FiSCA members about image-based check clearing over the last year, I find there are two distinct groups: those who are delighted with the benefits of the service, and those who have yet to try the service. I have found no dissatisfied users." Jim Ball (FiSCA VP and CEO of Fast Cash, Inc.) has been using a system for some time, and says it has saved him a considerable amount of money. Jerry Gagerman (CEO of Financial Clearings, Inc. and former FiSCA Chairman) said that when he first spoke to his current vendor, he thought they were trying to scam him. But the service has lived up to what he was promised: same-day good funds.

"Peter" (who did not want to be identified for this article), the operator of a busy check-cashing facility located in a large metropolitan center, had a different experience. True to his entrepreneurial spirit, he is among the first to try out a Check 21 system offered through his bank. He recently went back to manual processing. Basically, for his high-volume operation, the system simply did not work out. "The mistakes were amazing, and the paperwork was unmanageable. We had to hire a separate person just to key in each check and prepare the deposits." He also complained that the number of unreadable or incorrectly keyed items created problems. "The bank would automatically debit our account on those items, sometimes months later. Reconciling those items became a problem." Since the per-check processing

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fees were comparable to manual processing, the headache factor warranted jettisoning the machine.

Nevertheless, "Peter" does hold out hope for the technology. "It might be right for some smaller stores, or companies that aren't flush with capital. If you key in $100,000 in checks before 3:00 p.m., you're supposed to see it in your account that day or the next day." He also stressed that other systems that use a "point of sale" terminal, where the teller scans the check at the point of transaction, might be more workable and eliminate the labor intensity problems.

The bank or processor that perfects the Check 21 model for the check-cashing industry will likely reap big dividends. Imagine the potential for even a smaller community bank that is able to service check cashers over a multi-state footprint. With the help of James Wells, FiSCA is exploring the development of a Check 21 processing utility for our membership, and we have heard from a number of processors that have concepts for the industry. Additionally, we know of at least several financial institutions and processors that are in the running to deliver a system for check cashers, and some may even be planning to reach check cashers outside of their traditional market areas. The big question is who will be first to the finish line.

POINT OF BANKING POSSIBILITIES

Imagine the customers at your facility being able to make deposits and withdrawals from their credit union or bank accounts. New technologies and partnerships now make this a reality. Several years ago, the New York State Superintendent of Banks cut the ribbon to launch a revolutionary partnership between licensed check cashers and credit unions: the PayNet POB Program. Also lauded by the National Credit Union Administration, the initiative enables credit union members (and potentially bank customers) to perform depository account transactions at their neighborhood check-cashing outlet. Especially helpful to low-income individuals, this program enables them to make deposits and withdrawals to their credit union accounts, to cash their checks and leave some of the proceeds in checking or savings accounts, and even begin applying to become credit union members. The program is a benefit to the consumer, the check casher, and the credit union.

"This three-way partnership offers benefits to all parties," explains Joseph Coleman, President of Rite Check Financial Service Centers, located in Bronx, NY, and a pioneer in POB. "Through their check casher relationships, credit unions obtain an instantaneous 'brick and mortar' branch network. In turn check cashers are able to offer four new transactions, and receive a fee for each, while also attracting new customers. Finally, credit union customers get the unrivaled convenience of check-cashing locations and the value of credit union products. It's a triple win for everyone involved."

The New York program is a great example of the potential for financial service providers and depositories to work together. "As customer service becomes even more critical to attracting and keeping customers, more and more credit union–check casher partnerships will form," said Coleman. "It leverages both parties' strengths and just makes good business sense."

FUTURE TRENDS

People have been predicting a sharp downturn in the financial services industry for years, but it has not yet materialized. For example, in 1997, an Associated Press article made dire pronouncements that electronic banking threatened to eliminate check-cashing companies. Ten years later, we can safely say that we are still here. In fact, recent reports indicate that the number of check cashers has grown significantly. Moreover, financial service providers continue to expand into ancillary business lines: check cashers sell nearly one-fifth of all money orders sold in the U.S. (amounting to over $20 billion), and process about ten percent of all funds transfers.

Money transmitters in particular have experienced a robust growth over the last several years. According to a recent study sponsored by Inter-American Development Bank, remittances from the United States to Latin America in 2006 totaled more than $45 billion – up 51% from only two years ago.

One of the chief driving forces in the financial service industry's continued growth is its ability to adapt to the needs of its customers. Banco Popular's Michael Lynch notes that "Financial Service Centers continue to provide services that traditional banks are reluctant to enter into, such as bill payment services, money orders, prepaid debit cards, cell phone cards, etc. They are much more nimble in the marketplace, offering customers in local communities the services they want. They do a much better job at targeting their customers."

First Bank of Delaware's Alonzo Primus tends to agree that flexibility is the key to continued success. "I believe the financial services industry will need to continue to offer new type products in order to be competitive within the current landscape. Traditional 'Mom & Pop' locations are going

to be forced to offer ancillary services to offset some decline in check-cashing volume. An example may be payroll cards that customer paychecks can be loaded onto through an enrollment process."

Even so, although the industry appears to be on solid ground, banking and regulatory pressures are taking their toll on some companies, and in some areas we are beginning to observe a contraction within the industry. Corus Bank's Terry Keenan agrees. "I see smaller, single operators exiting the business as revenues drop and expenses go up. Larger operators have economies of scale and can better defray expenses."

Although we are very encouraged with FiSCA's progress thus far, it remains to be seen whether "self-certification" or other solutions will help to bring banks back. Likewise, Check 21's ability to help alleviate the crisis is difficult to predict. One thing, however, is certain: MSBs and their bankers are continuing to find ways to do business, and a number of new players are starting to enter the field.

The relationship between check cashers and banks, like any other long-term relationship, is bound to have its ups and downs; at times competitive, at times cooperative. At the end of the day, if banks and check cashers move forward together in the spirit of innovation, they will find new ways to be profitable together, thus ensuring that banks will love MSBs tomorrow – and vice versa. ■

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