

SUBJECT:           Redefinition and regulation of check sellers

COMMITTEE:       Financial Institutions — favorable, without amendment

VOTE:             7 ayes — Averitt, Solomons, Denny, Grusendorf, Hopson, Marchant,  
                      Menendez

                      0 nays

                      2 absent — Pitts, Wise

WITNESSES:       For — None

                      Against — None

                      On — Randall S. James, Texas Department of Banking; *Registered but did  
                      not testify*: Sarah Shirley, Texas Department of Banking

BACKGROUND:     Finance Code, chapter 152 requires a person to obtain a license from the  
                      banking commissioner to engage in the business of selling checks, or  
                      accepting a purchaser's money in exchange for issuing a payment instrument  
                      that the purchaser can use to pay a third party. Examples of the instruments  
                      sold include money orders and traveler's checks.

                      Among other requirements of current law, an applicant for a license to sell  
                      checks must meet financial criteria, be free of convictions for felonies and  
                      crimes of moral turpitude, pass a background check, and post a deposit or  
                      submit a surety bond of between \$100,000 and \$1 million to the Banking  
                      Commission, depending on the number of locations from which the applicant  
                      sells checks. To remain licensed, check sellers must maintain minimum  
                      levels of net worth and assets on hand, pay an annual \$500 licensing fee, file  
                      financial statements with the banking commissioner, and submit to annual  
                      examinations by the commissioner.

                      To protect consumers who purchase checks from the possibility that a check  
                      seller might be unable to meet its obligation to pay the consumer's designee,  
                      Finance Code, chapter 152 imposes a trust on the proceeds of a check sale in  
                      favor of the check holder. The commissioner can revoke a check seller's  
                      license for several causes and can examine the check seller's business

records if there is reasonable cause to believe that there are grounds to revoke a license. The commissioner can make rules regarding license applications and can adopt and enforce rules regarding acceptable practices for check sellers.

Finance Code, sec. 152.002(1) defines a check as “an instrument for the transmission or payment of money, including a draft, traveler’s check, or money order.” In 1995, the attorney general issued an opinion (DM-329) construing “instrument” to mean a negotiable *paper* instrument. Thus, chapter 152 does not apply to purely electronic transfers of money.

DIGEST:

**Redefining “check” and regulating electronic check sellers.** HB 1166 would amend the Finance Code’s definition of “check” to include not only an instrument (i.e., paper) for transmitting or paying money but also a “service” or “device” that transmits or pays money. This definition would include an electronic equivalent to a draft, traveler’s check, or money order, including an automated clearinghouse transfer, but would exclude direct transfers from a purchaser to a creditor or the creditor’s agent and transfers in which the purchaser redeems the instrument for goods or services with the same person or company that issued it. It also would exclude transfers of money that are regulated under Finance Code, chapter 153 as a currency exchange in a transmission or transportation transaction.

The bill would define “the business of selling checks” as receiving payment, in whatever form, from a customer to transfer money by check from the seller to the customer’s designee, provided that the check seller does this for compensation. The compensation could be earnings from the money received from the purchaser while it is held by the seller.

HB 1166 also would amend Finance Code, sec. 152.201 to specify that the licensing requirement applies to persons who sell checks to purchasers in Texas or to purchasers anywhere else if the seller is located in Texas. It would define an in-state check seller as one who use agents in Texas as well as one who maintains bank accounts in Texas for the purpose of engaging in check selling.

**Exemptions.** HB 1166 would amend Finance Code, sec. 152.202, dealing with exemptions from licensing, by:

- ! revising language that does not address the electronic check-selling environment;
- ! extending the exemption to federal and state instrumentalities, including the U.S. Postal Service; and
- ! modifying the partial exemption for those regulated under chapter 153, including by modifying the bonding requirements of those exemptees to require a bond equal to the greater of the amounts required in chapters 152 and 153; and
- ! eliminating a fixed net-worth threshold and allowing the commission to evaluate the sufficiency of the check seller's net worth.

Provided that the commissioner issued an opinion determining that the exemption was in the public interest, the bill would exempt those who:

- ! sell checks only as an activity incidental to another primary, non-check-selling business activity;
- ! do not advertise or market their check-selling service separately or in ways unnecessary to advertise their other primary business; and
- ! either do not charge a fee for the check-selling service or else sell checks only in connection with commercial contracts in interstate commerce.

The bill would allow the banking commission to create additional exemptions by rule.

**License requirements.** HB 1166 would amend license requirements by specifying the types of convictions that disqualify an applicant. These would include convictions within the preceding 10 years for crimes involving fraud, money laundering, or reporting requirements under the federal Bank Secrecy Act, as well as similar foreign convictions that would be a felony under state or federal law, unless the applicant demonstrated to the commissioner that such a conviction should not disqualify the applicant. A licensee could not owe delinquent taxes, fines, penalties, or fees to any local, state, or federal government entity.

**Bonding requirements.** HB 1166 would specify seven factors to be considered in determining the amount of the required bond, replacing the current criterion, which is the number of business locations an applicant maintains. These factors would be:

- ! the nature of the licensee's business;
- ! the licensee's financial condition relative to the dollar volume of checks sold;
- ! the type and liquidity of the licensee's assets;
- ! the competence, character, fitness, and experience of the licensee's management;
- ! the licensee's internal controls;
- ! the licensee's use of annual audits by independent accountants; and
- ! the existence and adequacy of other insurance the licensee maintains to protect its customers.

The bill would allow applicants to fulfill the bond posting requirements by posting other securities, as in current law, but would amend the list of acceptable securities to exclude stocks and to include other securities the commissioner specifies by rule, in addition to federal, state, or local bonds.

**Commissioner's rulemaking authority.** HB 1166 would amend Finance Code, sec. 152.102 to allow the banking commission to set fees for applications, licenses, notices, and examinations and to create exemptions from the statutory requirements if doing so would be in the public interest and based on "appropriate requirements or conditions."

**Examinations.** HB 1166 would establish requirements for examination of licensees. It would require the commissioner to examine licenses annually unless some other periodic examination schedule was determined by rule or unless the commissioner determined that more frequent examination of a licensee was necessary. The commissioner could defer a scheduled examination for up to six months and could examine a licensee at its primary place of business or examine off-site documents furnished by the licensee.

**Cooperation with other regulators.** The bill would allow the commissioner to engage in cooperative or joint regulation of licensees with other state and federal regulatory entities, including through:

- ! sharing information with those entities;
- ! accepting the examination reports of those entities instead of conducting the commission's own examinations;
- ! contracting with those entities and sharing the costs of and fees for examinations; and

- ! entering joint enforcement actions with such entities as long as the commissioner did not waive the authority to proceed separately later, if necessary.

**Confidentiality, privilege, and protection of trade secrets.** HB 1166 would add provisions to protect the confidentiality of information in the commissioner's examination reports. It would prevent the disclosure of information to the commissioner in the course of an examination from causing the examinee to lose its attorney-client privilege or trade-secret protection for the information. It would extend existing provisions protecting the confidentiality of a licensee's financial information to include information on license applicants and those exempt from licensing and "personal or private" information related to specific check purchasers. The bill would specify that the commissioner determines whether information is confidential under the terms of the statute.

HB 1166 also would amend the provisions specifying circumstances in which the commissioner can release confidential information by:

- ! modifying the consent provision so that the licensee's consent alone is insufficient for the release of a customer's information; and
- ! expanding the list of governmental entities to whom information can be released to include foreign governments with whom the United States maintains diplomatic relations.

**Application requirements.** HB 1166 would add to the requirements for license applications the applicant's social security or tax identification number and home address. An application for an individual would have to include the social security or tax ID number of the applicant's spouse, and an application for a business would have to include the social security or tax ID number of each principal of the applicant and of each principal of a principal. The application also would have to contain a detailed description of the applicant's business plan related to check selling, including the method and location of operation(s), two-year growth projections of the volume of check selling in both dollars and number of customers, and other information the commissioner needed to set the bond requirements. If an application was denied, the applicant could request a hearing that would have to occur within 60 days of the request.

**Other changes.** HB 1166 would make many technical changes to Finance Code, chapter 152 to conform existing language with the vocabulary and purpose of the more substantive changes. The bill would add definitions of “money,” “principal,” “financial institution,” and “license holder.” It would define “sell” to mean “transmit” as well as issue or deliver, and it would expand the definition of “permissible investment” to include not only U.S. government securities but those of states, local governments, and other political subdivisions and other assets or securities that the commissioner permits by rule or otherwise approves.

HB 1166 would take effect September 1, 2001.

**SUPPORTERS  
SAY:**

HB 1166 is essential to bring the statute related to check selling up to date with new technology. The current law, with its focus on paper instruments, allows Internet and other electronically-based companies to perform the same service as traditional check sellers with no regulation by federal or state governments designed to protect consumer’s interests. By enacting HB 1166, Texas would join 44 other states that regulate electronic check selling in addition to the more traditional variety.

The key to check selling is that the seller receives the purchaser’s money with instructions to deliver it to a third party and holds those funds in the check seller’s own account pending the transfer to the purchaser’s designee. Current law, however, does not require licensing of those who operate purely electronically but otherwise would meet this definition of check selling. Such unregulated services include Internet-based bill-payment services and wire-transfer instructions given to a grocery store, by which the store draws the wired funds from the customer’s bank account electronically. Because these kinds of businesses hold a consumer’s money in their own accounts before transferring it to pay the consumer’s bill, the consumer is at great risk if the company is unscrupulous or undercapitalized. By redefining “check” and “check selling,” HB 1166 would require these companies to seek and obtain licenses from the Banking Department, post a surety bond or other assets to ensure payment of the checks they sell, undergo periodic examination by the banking commission, and maintain certain levels of cash or other liquid assets on hand.

Besides protecting consumers, HB 1166 also would be fair to businesses. The amount of the required bond would be capped at \$1 million to avoid

overburdening small businesses, especially as any risk of a low bond amount would be offset by the cash-on-hand requirements.

Furthermore, the bill would exempt those for whom check selling is only incidental to their primary business and who do not charge for or advertise this service. For example, trucking companies often contract with financial services companies to store value on debit-type cards that the truckers use to pay travel expenses on the road.

Many of the companies that HB 1166 would bring under regulation are “e-commerce” companies, such as Internet bill-payment services. The financial standards that the bill would require for licensees, such as bond, asset, and liquidity requirements, are especially important given the recent volatility in the technology sector. If the state waits until after a financial catastrophe to regulate this industry, the response could be overly zealous and burdensome.

Though some Internet bill-payment services are associated with banks, many are not. Many consumers, however, either assume or are led to believe that they are dealing with a bank or other regulated financial institution. HB 1166 would bring the law into line with consumers’ expectations. Furthermore, by bolstering consumer confidence in the industry, new regulatory requirements could increase the number of consumers willing to use electronic payment and money-transfer services.

Given the intent to regulate electronic transactions and Internet money-transfer services, the focus of current law on the number of locations or storefronts that a licensee maintains in setting the bond amount is outdated and irrelevant. HB 1166 would update the factors that the commissioner must consider in setting the bond amount to include those that truly relate to a licensee’s financial stability and practices.

The rapidly evolving nature of this industry requires flexibility in regulation. HB 1166 would extend the commission’s already substantial rulemaking authority and other discretion. For example, the commission could create exemptions from licensing by rule. However, the bill would limit this authority sufficiently to avoid an unconstitutional delegation of legislative authority. The commission could create exemptions only if they were in the public interest and subject to appropriate requirements or conditions. The

public-interest language would be substantially the same as in the current statute and has not been challenged.

With an eye to the fact that most other states regulate check sellers, HB 1166 would allow the commission to cooperate with other regulatory bodies in examining check sellers. This would minimize regulatory costs to the state and licensees, promote uniformity across jurisdictions, and prevent the federal government from finding the need to preempt the state in its regulation of this industry. The commission needs broad discretion to maintain flexibility in multi-state regulation of check sellers.

HB 1166 also would balance the banking commission's need for information about applicants and licensees against the privacy and trade-secret concerns of applicants, licensees, and consumers by strengthening the provisions that protect the confidentiality of the information that applicants and licensees provide to the commission. Furthermore, by allowing the commissioner to determine whether documents and information are confidential, the bill could discourage litigation seeking to establish or refute confidentiality in the first instance.

OPPONENTS  
SAY:

HB 1166 would give the banking commissioner too much discretion in regulating check sellers. For example, the commissioner not only could set a licensee's bond requirements but also could evaluate the competence, character, fitness, and experience of the licensee's management in setting that bond. Likewise, the commissioner could determine what information falls within the categories of protected confidential information. The bill also would give the commissioner too much latitude in deciding the type of information an applicant must provide as part of the required business plan.

The licensing scheme proposed in HB 1166 also could be very burdensome for e-businesses that operate in all 50 states and are regulated separately. For example, the commissioner could require a bond of up to \$1 million. Such a large bond, if required by many states, could become a serious burden on the company. The bill would not allow consideration of bonds filed with other state regulators in determining the bond amount in Texas. Federal regulation or reciprocal licensing among the states would be a better way of overseeing these interstate companies.



OTHER  
OPPONENTS  
SAY:

The \$1 million limit on a bond that the commissioner could require is too low and might not protect consumers adequately in all cases.

NOTES:

The companion bill, SB 711 by Carona, was reported favorably without amendment by the Senate Business and Commerce Committee on March 15 and was recommended for the Local and Uncontested Calendar.