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Check Cashers and Banker's Discontinuance of Services

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Abstract. Check cashers are dependent on access to bank services to operate. Banks provide depository accounts, check collection and clearing operations, funds transfer, and access to lines of credit for liquidity purposes. Banks and check cashers are both subject to Bank Secrecy Act (BSA) regulations. The BSA is an anti-money laundering and antiterrorism financing statute. Federal regulators have cautioned banks that nonbank money service businesses (an umbrella term that includes check cashing enterprises) can present heightened money laundering risks. Consequently, some banks have discontinued their business relations with check cashers. The discontinuance of services to check cashers brought about complaints to regulators and increased lobbying of Congress. Bank regulators have issued guidance to clarify BSA compliance expectations. Congress held hearings on the concerns of banks and check cashers.

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CRS Report for Congress

Check Cashers and Banker's Discontinuance of Services

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Summary

A check cashing enterprise is a fee-based business that will cash a customer's check without requiring an account relationship. The U.S. check cashing industry underwent a significant expansion in the 1990s. Customers are attracted by the immediate access to funds, availability of service without a bank account, and convenience of extended hours of operation. In general, the industry is viewed as a provider of valuable financial services to an under served market segment.

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Introduction

Check cashers are nonbank businesses that cash checks for a fee. Check cashing businesses may offer additional fee-based products and services including money orders, processing utility bill payments, pre-paid phone cards, and funds transfers. These enterprises often operate in neighborhoods not well served by banks. Check cashers provide access to financial services for individuals without accounts at conventional

¹ P.L. 91-508.

banks. To provide these services, a check cashing enterprise establishes a business relationship with a bank to clear checks, transfer funds, and open lines of credit for liquidity purposes.

The Bank Secrecy Act regulations define check cashers as money services businesses (MSBs). Both banks and nonbank MSBs must have written anti-money laundering programs, file currency transaction reports (CRTs) and suspicious activity reports (SARs), and maintain certain records. MSBs, including check cashers, must register with the Financial Crimes Enforcement Network (FinCEN), a bureau of the U.S. Treasury. Banks providing services to check cashers are expected to have systems to manage the risks associated with these accounts.

The following developments created difficulties to obtaining and maintaining access to banking services.

- The Office of the Comptroller of Currency (OCC) a federal bank regulatory agency included check cashers and other MSBs in a list of inherently high-risk businesses in its Bank Secrecy Act/ Anti-Money Laundering Manual.
- The OCC has also stated that the risk profiles of individual businesses can vary widely based on the variety and range of financial services offered.
- FinCEN strengthened BSA enforcement after the enactment of the USA PATRIOT Act² and with the increased focus on terrorism financing after 9/11.
- Banker's compliance costs were affected by the risks associated with a check cashing business.
- Substantial fines were levied by bank regulators on banking institutions for BSA non-compliance.

The potential price of doing business proved to be prohibitive for a number of banks, resulting in discontinuance of services to check cashers.

In April 2005, bank regulators issued interagency guidance³ in response to concerns over the loss of access to banking services by check cashers and other MSBs. Concern is twofold: (1) widespread termination of account relationships could result in the loss of access to financial services and products by the significant market segment currently served by check cashers and (2) if these businesses are consequently forced "underground" the potential loss of transparency could damage ongoing efforts to safeguard the U.S. financial system. The guidance addressed both the ability of check cashers and other MSBs to obtain services and the caution to be maintained by banks dealing with these businesses. The goal was to clarify the regulatory expectations for banking institutions providing services to domestic businesses. It is generally acknowledged that the trend of individual banks terminating account relationships with

² P.L. 107-56.

³ Financial Crimes Enforcement Network, "Interagency Interpretive Guidance on Providing Banking Services to Money Services Businesses Operating in the United States," joint press release, Apr. 26, 2005, at [<http://www.fincen.gov/nr04262005.pdf>].

check cashers has continued. On June 21, 2006, the Subcommittee on Financial Institutions and Consumer Credit of the House Financial Services Committee held an oversight hearing to assess the impact of the BSA obligations on check cashers and other MSBs.

Background

The Industry. The nonbank check cashing industry can trace its origins back to the 1930's when employers began paying workers by check as opposed to cash. Workers without traditional bank accounts used check cashers, where an account relationship is not required, to convert those paychecks into cash for a fee. Today's check cashing enterprise may offer additional fee-based products and services including money orders, processing utility bill payments, pre-paid phone cards and funds transfers. Money transfers may include foreign worker remittances (money sent back to the workers' home countries). Some also offer credit products such as payday loans, where customers are given cash for a postdated personal check for the amount of cash requested plus the check casher's fee. Check cashing services can be offered as an ancillary component of a business, such as a liquor stores that cashes payroll checks. Items cashed are primarily payroll checks, government checks, personal checks, cashier's checks, money orders, and traveler's checks. The typical value of a cashed item ranges from \$300 to \$600.⁴ Most fees range from 1% to 12% of the check's value.⁵ The main financial risk for the check casher is a returned check unpaid by the bank on which it was drawn. Fees vary by type of check. For example, the fee for a personal check is usually greater than for a government check. Many states require a license for check cashing enterprises and/or regulate their fee structures. Some states have additional restrictions for pay day lending.⁶

The check cashing industry has experienced a period of significant growth since the early 1990's. One estimate for 1990 indicated that the check cashing industry comprised approximately 4,250 businesses that cashed 128 million checks with a total face value of \$38 billion.⁷ In 2002, an estimated 11,000 check cashing enterprises cashed approximately 180 million checks with a total face value of \$55 billion.⁸ Customers are drawn to check cashers for a variety of reasons. Check cashers typically offer convenient hours of service that extend beyond the normal hours of operation found at mainstream banking institutions. The barriers involved with opening an account at a bank such as minimum account balances, specific identification requirements, and credit checks are not encountered. In addition, the check holder is not subject to the variety of fees and services

⁴ Catherine Stahlmann, "Check Cashers and Money Transmitters Serious Risks or Just Misunderstood?," Federal Reserve Bank of Atlanta, May 2003, p. 3.

⁵ Howard Karger, *Shortchanged; Life and Debt in the Fringe Economy* (San Francisco: Berrett-Koehler, 2005), p.89.

⁶ Information on state laws can be found on the National Conference of State Legislatures website, [<http://www.ncl.org>].

⁷ John P. Caskey, *Fringe Banking: Check-Cashing Outlets, Pawnshops, and the Poor* (New York: Russell Sage Foundation), p. 65.

⁸ Howard Karger, *Shortchanged; Life and Debt in the Fringe Economy*, San Francisco: Berrett-Koehler, 2005), p. 6.

charges typically associated with a bank account. A customer's funds are immediately available while banks may impose check clearing holds.

Customers of check cashing businesses tend to be low and moderate income consumers. The so called "unbanked" consumers rely on alternative financial services offered by nonbanks. There are a significant number of unbanked families in the United States; they do not hold a checking or savings account at a federally insured financial institution. Studies vary, but it is generally estimated that about 10 million U.S. households do not own a bank account.⁹ The costs associated with maintaining accounts, dislike of banking institutions, and the convenience offered by alternative nonbank service providers are among the more frequently given reasons for their popularity. Conversely, it is estimated that 58% of the check cashing industry's clientele are bank account holders.¹⁰

Bank Secrecy Act. In 1970, the Bank Secrecy Act was enacted to create a federal anti-money laundering program. In 2001, Title 111 of the USA PATRIOT ACT¹¹ amended the BSA with provisions to strengthen the existing program and to counter terrorist financing. The Financial Crimes Enforcement Network, a bureau of the U.S. Treasury Department, administers and issues regulations pursuant to the BSA. Check cashing enterprises that meet the definition of a money service business are required to register with FinCEN.¹² Banks providing services to check cashers are expected to have in place systems to manage the risks associated with these accounts.

BSA reporting and record keeping requirements apply to both banks and MSBs. Both must establish anti-money laundering programs commensurate with the risks posed by their size, location and financial activities. Both are required to file currency transaction reports (CTRs) for cash transactions over \$10,000 and to maintain a log on the sale of financial products such as money orders or travelers checks valued from \$3,000 to \$10,000. Information must also be maintained on funds transfer of \$3,000 or more. Finally, MSBs are required to file suspicious activity reports (SARs).¹³ FinCEN has

⁹ Michael S. Barr, "Banking the Poor," a working paper prepared for the Brookings Institution Center on Urban and Metropolitan Policy, July 2003, p.8.

¹⁰ Catherine Stahlmann, "Check Cashers and Money Transmitters Serious Risks or Just Misunderstood?", Federal Reserve Bank of Atlanta, May 2003. p. 2.

¹¹ P.L. 107-56. For more detailed information on this act and pre-existing law, see CRS Report RL31208, *International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001, Title 111 of P.L.107-56*, by M. Maureen Murphy.

¹² Nonbank MSBs are defined as a business offering one or more of the following services: money orders, traveler's checks, check cashing, currency dealing or exchange, and stored value. In addition, registration with FinCEN is required if the business conducts more than \$1,000 in money services business activity with the same person in one day or provides money transfer services in any amount.

¹³ For detailed information on BSA requirements for MSBs, see *Money Laundering Prevention: A Money Services Business Guide*, found at the MSB website, at [<http://www.msb.gov>].

delegated the authority to examine check cashers for BSA compliance to the Internal Revenue Service (IRS).¹⁴

2005 Interagency Guidance. The intent of the interagency guidelines was to clarify the supervisory expectations of banks to remain in compliance with the requirements of the BSA while providing services to check cashers and other MSBs. The guidance was issued to assist banks in developing appropriate BSA risk assessments. Another goal was to help ensure check cashers and other MSBs have reasonable access to banking services. Concurrent with the 2005 guidance, an advisory was issued addressing the BSA obligations of check cashers and outlining the documentation an MSB may be expected to provide when establishing an account relationship at a bank. The advisory was issued as part of an ongoing campaign to inform MSBs about their BSA requirements. FinCEN has recognized that outreach to the MSB industry is essential; they found that many of the businesses, especially the smaller operations, are unfamiliar or unaware of their obligations.

The 2005 interagency guidance directed banks opening and maintaining accounts for MSBs to apply the requirements of the BSA on a risk-assessed basis. Five minimum due diligence expectations are presented: (1) apply the bank's Customer Identification Program, (2) confirm FinCEN registration, (3) confirm compliance with state or local licensing requirements, (4) confirm agent status (many MSBs operate through a system of agents), and (5) conduct a basic Bank Secrecy Act/Anti-Money Laundering risk assessment to determine the level of risk associated with the potential account and whether further due diligence is necessary. The guidance outlines further due diligence criteria, beyond the minimum expectations, that may be called for by the risk profile of the individual money service business.¹⁵

Banks' relationship with Check Cashers. Check cashers require specific banking services to operate. These financial services include depository accounts, check collection and clearing operations, funds transfer, and access to lines of credit for liquidity purposes. Banks generate fee income for financial services provided. An individual banking institution's experience with check cashers is often dependent on the proximity between the two. Some banks specialize in servicing check cashers. Consequently, the decision of an individual bank to discontinue services to check cashers could have a significant impact. For example, according to the Financial Services Center of America (FISCA), in New York 12 banks currently provide services to check cashers but 87% of the 640 licensed check cashers do business with only two of these banks.¹⁶

BSA compliance requirements and supervisory expectations are viewed as burdensome and have caused banks to re-evaluate the costs and benefits of opening and

¹⁴ For more information on the IRS compliance monitoring, see CRS Report RS22003, *Enforcement of Bank Secrecy Act Requirements: Money Services Businesses*, by Nathan Brooks.

¹⁵ The full text of the interpretive guidance can be found on FinCEN's website at [<http://www.fincen.gov/nr04262005.pdf>].

¹⁶ Testimony of Gerald Goldman, General Counsel, Financial Services Center of America, before the U.S. Congress, House Committee, Subcommittee of Financial Institution and Consumer Credit, *Bank Secrecy Act's Impact on Money Services Businesses*, June 26, 2006, p. 2 [<http://financialservices.house.gov/media/pdf/062106gg.pdf>].

maintaining accounts for check cashers. Banking representatives testifying at the June 2006 oversight hearing stated that the level of BSA risk assessment and monitoring required of them by the regulatory agencies remains burdensome and costly despite the 2005 guidance. Of particular concern is determining the delineation between low and high risk profiles and the corresponding *due diligence* expectations. In addition, bankers suggested that regulators should not expect a bank's monitoring activity to extend beyond the check cashing business to the activity of the check casher's customers. They argue FinCEN should further clarify that banks are not expected to be de facto regulators of check cashers by instituting a system that more clearly defines the responsibility for oversight of the BSA obligations of check cashers and other MSBs.

Policy Issues

In March 2006, a FinCEN news release¹⁷ acknowledged the ongoing concerns of both the banking industry and money service businesses relating to BSA regulations despite the previous steps taken (including the April 2005 guidance) to address the issues. The difficulties involve how to minimize the resources and costs borne by financial institutions while ensuring the effective administration of the anti-terrorism financing and anti-money laundering programs. The news release announced an Advanced Notice of Proposed Rulemaking seeking input on what additional guidance or regulatory action would be appropriate to address the ongoing concerns about check casher's and other MSB's access to banking services. The news release emphasized the important role of MSBs and the negative effect on the health and safety of the U.S. financial system if these businesses are driven underground. Comments received by FinCEN are under review and potential next steps are being considered.

On June 21, 2006, the Subcommittee on Financial Institutions and Consumer Credit of the House Committee on Financial Services held an oversight hearing on the Bank Secrecy Act's impact on money services businesses. There was general agreement that banks were re-evaluating their businesses strategies in light of BSA *due diligence* costs. There were reports of individual institutions concluding that opening and maintaining accounts for MSBs did not make economic sense. Regulatory and supervisory adjustments were discussed as a means of easing the burden on banks. Stronger state MSB regulatory oversight was encouraged. Joint industry/government training on BSA obligations for banks, bank examiners, and MSBs was suggested. In addition, FiSCA (the trade association, representing 6,000 check cashing operations and nonbank financial service centers), suggested the need for legislation that would remove state regulated check cashers from "high risk" categories. In its view, legislation could also limit administrative enforcement actions against banks that service check cashers in good faith.

¹⁷ The full text of the news release and the text of the Advanced Notice of Proposed Rulemaking from the March 10, 2006 Federal Register, can be found on FinCEN's website [http://www.fincen.gov/msb_anpr.pdf].