

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: CS/HB 1277 Money Services Businesses
SPONSOR(S): Insurance & Banking Subcommittee and Davis
TIED BILLS: HB 1279 **IDEN./SIM. BILLS:** CS/SB 1586

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Insurance & Banking Subcommittee	13 Y, 0 N, As CS	Barnum	Cooper
2) Economic Affairs Committee	14 Y, 0 N	Barnum	Tinker

SUMMARY ANALYSIS

In 2011, the Chief Financial Officer convened the Money Service Business Facilitated – Workers' Compensation Work Group to study the issue of workers' compensation premium fraud in Florida, as facilitated by check cashers, and develop recommendations to resolve the issue. The fraud makes possible avoidance of tax collections by the state, results in underpayment of workers compensation insurance premiums to the carriers, and places law-abiding contractors at a competitive disadvantage when competing, on a price basis, with contractors benefitting from the fraud.

The Office of Financial Regulations (OFR) is responsible for licensing money services businesses. There are currently 1,065 licensed businesses authorized to cash checks. Customer files, documentation, and records are reviewed during an examination or investigation by the OFR. Under current law, an examination must be conducted within 6 month of a license being issued, and then at least every 5 years. Because of the OFR's workload and limited assets, after the initial examination, a licensee can assume, with reasonable certainty, that it will not be examined again for several years, and knows that it will be provided advance notice. Thus, those conducting illegal activities are able to hide, destroy, or tamper with pertinent records or materials.

Check cashers who negotiate suspect checks may encounter difficulties in having their own financial institutions honor the checks, and credit their accounts. This incentivizes some to sell checks that their financial institutions will not honor. Selling of payment instruments within 5 business days after acceptance is permissible under current law. When money service businesses do not properly negotiate, endorse, or deposit checks, it may be difficult for the OFR to detect irregularities or illegalities.

The bill eliminates the requirement that the OFR provide a 15-day advance notice to money services business licensees prior to conducting an examination or investigation. This reduces the opportunity for hiding, destroying, or otherwise tampering with records and materials which may be pertinent to the OFR's examination or investigation. While retaining the requirement that each licensee be examined at least once every 5 years, the bill eliminates the requirement that the OFR conduct an examination of a business within 6 months of licensure. This will provide greater flexibility to the OFR by permitting use of its resources in a more targeted manner. Both changes reduce the predictability of when a business may be examined.

The bill requires that a check cashing business deposit payment instruments into its own commercial account at a federally insured financial institution and deletes the authorization to sell payment instruments within 5 business days after acceptance. Audit trails and tracking of moneys are facilitated by requiring that the deposit of all payment instruments be made into the business's own account.

The bill authorizes disciplinary action and provides for penalties should a check casher fail to maintain a depository account in its own name, or fail to deposit all payment instruments into its own account.

The bill stipulates that a check casher may only accept or cash a payment instrument from a person who is the original payee or a conductor who is an authorized officer of the corporate payee named on the instrument's face. In addition, it codifies the \$5 verification fee currently established by rule. Acceptance and cashing of third-party checks is no longer authorized.

The bill has an indeterminate positive impact on state government and no impact on local government.

The bill provides for an effective date of July 1, 2012

This document does not reflect the intent or official position of the bill sponsor or House of Representatives.

STORAGE NAME: h1277b.EAC

DATE: 2/16/2012

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

Background:

In 2008, the Attorney General impaneled the Eighteenth Statewide Grand Jury to look into the issue of fraudulent insurance and other organized criminal enterprises. In March 2008, it published the Second Interim Report of the Statewide Grand Jury entitled "Check Cashers: A Call for Enforcement." As a result, Ch. 560, F.S., Money Services Business, underwent a major re-write to address concerns with fraudulent insurance and money laundering activities. While the reforms were positive, the legislation did not cure the problem of facilitators creating shell companies for the purpose of purchasing workers compensation insurance policies and then, for a fee, allowing uninsured contractors to use those certificates of insurance.

In 2011, the Chief Financial Officer convened the Money Service Business Facilitated – Workers' Compensation Work Group to study the issue of workers' compensation premium fraud in Florida, as facilitated by check cashers, and develop recommendations to resolve the issue. It was comprised of representatives from state government and industry stakeholders. A report containing the work group's recommendations and other relevant materials are available online.¹

Workers' compensation insurance fraud continues to be a problem within Florida's construction industry. The scheme involves facilitators, contractors, and money services businesses. Facilitators create fake shell companies, typically incorporated online through the Department of State, so as to avoid true review and verification. The shell companies then purchase a minimal workers' compensation insurance policy, usually by describing its operations as a two to four person company. The facilitator may then approach an uninsured subcontractor who is looking for work but lacks the valid workers' compensation policy necessary to obtain contracts from a general contractor. The facilitator makes the shell company's name and workers' compensation policy available for use by the uninsured subcontractor, for a fee. Subsequently, a general contractor, knowingly or unknowingly, uses the uninsured subcontractor to perform work.

Once the uninsured subcontractor completes work under the guise of the shell company, payment will be made to him/her from the general contractor via company check made payable to the shell company. Typically, the check cannot be cashed at a bank because most banks will not cash a check made payable to a business or third party, but rather will require that the check be deposited into the payee's bank account. However, money service businesses will allow the cashing of the third-party business-to-business checks by certain "authorized" persons related to the payee. These "authorized" persons are the facilitator and others designated by the facilitator. Many times, these people have been introduced to the money service business' employees in advance, and limited powers of attorney listing these "authorized" persons are found in the "Know Your Customer" files of the money service business's records.

When checks made payable to the shell company are negotiated at the complicit money services business, two fees are taken out. One, usually between 1.5% and 2%, is taken out for the money services business as the fee for cashing the check. The second fee, usually between 6% and 8%, is taken out for the facilitator, as the fee for use of the shell company's name and workers' compensation insurance policy. The balance of the check is then returned to the uninsured subcontractor, posing as the shell company, in cash. The money paid in this manner is not reported to the shell company's workers' compensation insurance carrier, effectively avoiding the payment of any workers' compensation premiums or applicable payroll taxes. The payments are not considered payroll exposure because, on paper, the transaction appears to be a legitimate contractor to insured subcontractor payment.

¹ <http://www.myfloridacfo.com/sitePages/agency/sections/MoneyServiceBusiness.aspx> (Last visited on January 26, 2012).

Some money service businesses are at least tacitly aware of the fraud and their role in its success. Complicit money service businesses falsify required documents regarding the true identity of those persons authorized to conduct the transactions. To do this, they will complete Currency Transaction Reports for transactions in excess of \$10,000 in the name of the owner of the shell company, rather than the facilitator, to protect the latter's identity.

Facilitators may duplicate this scheme multiple times using the same workers' compensation insurance policy. Upon becoming concerned with detection, they close the shell company, which only exists on paper, and form a new entity. Shell company documentation often reflects questionable information, such as an owner who does not exist or is in the country illegally. Therefore, it is difficult link these fraudulent activities.

Uninsured subcontractors, by avoiding actual workers' compensation premiums, are able to pass that cost savings on to general contractors, some of whom may be complicit in this fraud. Contractors and subcontractors who are in compliance with the state's workers' compensation insurance laws are placed at a competitive disadvantage when competing, on a price basis, with contractors benefitting from the fraud.

These fraudulent activities make possible avoidance of tax collection by the state. They result in underpayment of workers compensation insurance premiums to the carriers. Additionally, when an uninsured worker is injured, the costs are ultimately paid for by all taxpayers.

Current Situation:

The Office of Financial Regulations (OFR) is responsible for licensing money services businesses. There are currently 1,065 licensed businesses having authority to engage in check cashing.² Current law provides that the requirement for licensure does not apply to a person cashing payment instruments that have an aggregate face value of less than \$2,000 per person per day and that are incidental to the retail sale of goods or services, within certain parameters. The \$2,000 benchmark was selected in 2008 after conversations with interested parties including representatives from Jackson Hewitt, Wal-Mart, Amscot Financial, Inc., and others. The \$2,000 amount was felt to still provide protection against fraudulent insurance and money laundering activities, and was consistent with the IRS's reported average federal tax refund.

There are no federal regulations which require a bank to cash a check for an individual who does not have an account with that bank. A 2009 Federal Deposit Insurance Corporation national survey of unbanked and underbanked household reported that an estimated 7.7% of U.S. households do not have a checking or savings account. According to the survey, 527,000 or 7% of Florida's households are unbanked.³

Check cashers are limited in the fees they may charge. By law, a check casher may not charge fees:

- In excess of 5% of the face amount of the payment instrument, or \$5, whichever is greater.
- In excess of 3% of the face amount of the payment instrument, or \$5, whichever is greater, if the payment instrument is any kind of state public assistance or federal social security benefit.
- For personal checks or money orders in excess of 10% of the face amount of those payment instruments, or \$5, whichever is greater.⁴

Check cashers are authorized to collect a fee linked to the direct costs of verifying such things as a customer's identity or employment. That fee, established by rule, may not exceed \$5.⁵

Documentation and record keeping requirements for Florida-licensed check cashers are established in law. These specify that, for any payment instrument accepted having a face value of \$1,000 or more,

² Office of Financial Regulation HB 1277 Bill Analysis dated January 20, 2012, on file with the Insurance & Banking Subcommittee.

³ <http://www.fdic.gov/householdsurvey> (Last visited on January 26, 2012).

⁴ s. 560.309(8), F.S.

⁵ 69V-560.801, F.A.C.

the check casher must maintain a copy of the personal identification that bears a photograph of the customer used as identification and a thumbprint of the customer taken by the licensee. Licensees are required to affix customer thumbprints to the original of each payment instrument exceeding \$1,000, as well as secure and maintain a copy of the original payment instrument, a copy of the customer's personal identification presented at the time of acceptance, and maintain customer files for those cashing a corporate and third party payment instrument. Those customer files must include documentation from the Secretary of State verifying the corporate registration, Articles of Incorporation, information from the Department of Financial Services Compliance Proof of Coverage Query Page, and documentation of those authorized to negotiate payment instruments on the corporation's behalf. The files must be updated annually. Record keeping requirements for check cashers when the payment instrument is \$1,000 or more, at a minimum, must include:

- Transaction date.
- Payor name.
- Payee name.
- Conductor name, if other than the payee.
- Amount of payment instrument.
- Amount of currency provided.
- Type of payment instrument.
- Fee charged for the cashing of the payment instrument.
- Branch/Location where instrument was accepted.
- Identification type presented by conductor.
- Identification number presented by conductor.

It is required that logs of these transactions be maintained in an electronic format that is readily retrievable and capable of being exported to most widely available software applications including Microsoft EXCEL.⁶

Customer files, documentation, and records are reviewed during an examination or investigation by the OFR. By law, an examination must be conducted within 6 months of a license being issued, and then at least every 5 years.⁷ With few exceptions, the OFR is required to provide at least 15 days' notice to a money services business prior to conducting an examination or investigation.⁸ Thus, those conducting illegal activities are able to hide, destroy, or tamper with pertinent records or materials. Because of the OFR's workload and limited assets, after the initial examination, a licensee can assume, with reasonable certainty, that it will not be examined again for several years and, when the examination or investigation does occur, it will receive advance notice.

Check cashers who negotiate suspect checks may encounter difficulties in having their financial institutions honor the checks, and in turn, credit their accounts. This incentivizes some check cashing facilities to sell checks that their financial institutions will not honor. Selling of payment instruments within 5 business days after acceptance is permissible under current law.⁹ When money service businesses do not properly negotiate, endorse, or deposit checks, it may be difficult for the OFR to detect irregularities or illegalities.¹⁰

Effect of the bill:

The bill eliminates the requirement that the OFR provide a 15-day advance notice to money services business licensees prior to conducting an examination or investigation. This change reduces the opportunity for hiding, destroying, or otherwise tampering with records and materials which may be pertinent to the OFR's examination or investigation. While retaining the requirement that each licensee be examined at least once every 5 years, the bill eliminates the requirement that the OFR conduct an examination of a business within 6 months of the business becoming licensed. This will provide greater

⁶ 69V-560.704 F.A.C.

⁷ *Id.*

⁸ s. 560.109(1), F.S.

⁹ s. 560.309(3), F.S.

¹⁰ *A Report by the Money Services Business Facilitated Workers' Compensation Fraud Work Group*

flexibility to the OFR by permitting use of its resources in a more targeted manner. Both changes reduce the predictability of when a business may be examined.

The bill requires that a check cashing business deposit payment instruments into its own commercial account at a federally insured financial institution and deletes the authorization to sell payment instruments within 5 business days after acceptance. Audit trails and tracking of moneys are facilitated by requiring that the deposit of all payment instruments be made into the business's own account. Maintaining such an account is a prerequisite for continued operation. A licensee is required to notify the OFR within 5 business days after it ceases to maintain a commercial depository account in its own name and, before resuming check cashing, must reestablish such an account and notify the OFR that the account exists.

The bill authorizes disciplinary action and provides for penalties should a check casher fail to maintain a depository account in its own name, or fail to deposit all payment instruments into its own account. Possible disciplinary actions include denial, revocation, or suspension of a license. In addition, it provides a definition for "fraudulent identification paraphernalia"¹¹ and specifies that that possession and use of fraudulent identification paraphernalia is a prohibited act punishable as a felony of the third degree.

The bill stipulates that a check casher may only accept or cash a payment instrument from a person who is the original payee or a conductor who is an authorized officer of the corporate payee named on the instrument's face. Acceptance and cashing of third-party checks is no longer authorized.

The bill codifies the \$5 fee, currently established by rule, which is linked to the direct cost of verifying such things as a customer's identity or employment.

The bill provides for an effective date of July 1, 2012.

B. SECTION DIRECTORY:

Section 1: Amends s. 560.103, F.S., relating to definitions.

Section 2: Amends s. 560.109, F.S., relating to examinations and investigations.

Section 3: Amends s. 560.111, F.S., relating to prohibited acts.

Section 4 Reenacts and amends s. 560.114, F.S., relating to disciplinary action penalties.

Section 5: Amends s. 560.126, F.S., relating to required notice by licensee.

Section 6: Amends s. 560.309, F.S., relating to conduct of business.

Section 7: Amends s. 560.310, F.S., relating to records of check cashers and foreign currency exchangers.

Section 8: Provides an effective date of July 1, 2012.

¹¹ "Fraudulent identification paraphernalia" means all equipment, products, or materials of any kind that are used, intended for use, or designed for use in the misrepresentation of a customer's identity. The term includes a signature or thumbprint stamp, blank, stolen, counterfeit, or unlawfully issued personal identification.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

Indeterminate. There may be an increase in tax revenue as underpayment of workers' compensation insurance premium and falsified reporting of payroll are reduced.

2. Expenditures:

None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

- Elimination of the competitive advantage resulting from use of subcontractors without workers' compensation insurance may result in additional business for law-abiding contractors.
- By ensuring all appropriate individuals are covered by workers compensation insurance, the cost of care for the uninsured, which is ultimately paid for by all taxpayers, may be reduced.

D. FISCAL COMMENTS:

None.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

Not applicable. This bill does not appear to: require counties or municipalities to spend funds or take an action requiring the expenditure of funds; reduce the authority that counties or municipalities have to raise revenues in the aggregate; or reduce the percentage of a state tax shared with counties or municipalities.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

None.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES

At the January 30, 2012 meeting of the Insurance & Banking Subcommittee, a Proposed Committee Substitute was considered and adopted. It was reported favorably as a Committee Substitute.

The Proposed Committee Substitute:

- Removed authorization for the establishment and administration of a centralized database of check cashing transaction information.
- Removed the requirement for real-time reporting of transaction data.
- Removed the funding mechanism for establishment, maintenance, and administration of the centralized database.

The analysis is drafted to the Committee Substitute.