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MEMORANDUM

TO: Senator Ann Cummings
FROM: Aaron Ferenc, Deputy Commissioner of Banking
SUBJECT: Updates to money transmitter law to adopt nationwide model law
DATE: February 29, 2024

In August 2021 the Board of Directors of the Conference of State Bank Supervisors (CSBS), the nationwide organization of state regulatory agencies with responsibilities for overseeing banks and other financial entities, adopted a model law addressing entities that engage in money transmission – the Model Money Transmission Modernization Act. “Money transmitters” are a quickly expanding, broad category of companies that, in lay person terms, facilitate the exchange of money or monetary value among people or entities, often along with offering other services.

The statistics in Vermont shed light on how fast this area is growing. In 2021 the Department of Financial Regulation issued 30 money transmitter licenses. Today, 161 companies hold licenses. Licensed money transmitters range from retail entities like Pay Pal and Venmo that many consumers use every day, to payroll processing companies that serve employers, to virtual currency related businesses. Money transmission activities are also an area of commerce where complex business models are frequently employed by companies to structure activities in a way that avoids regulation.

The goal of the Model Money Transmission Modernization Act is to establish a single, nationwide set of standards and requirements for regulating money transmitters, benefiting regulators, the public, and the regulated entities themselves. The model law was adopted after extensive engagement by CSBS with both state regulators and industry representatives. The Department proposes to adopt and integrate the model law, making minimal changes to conform the model to the language used throughout the banking statutes and the Department’s administrative processes for regulating financial entities. The Department’s proposal also includes an update to clarify and update the regulation of money transmitters in the virtual currency space, an area that the Department and Vermont has taken a lead on among states. While the model law provides optional provisions related to virtual currency businesses it does not endeavor to propose nationwide standards; thus, the Department’s proposal regarding virtual currency includes some additional protections and requirements not included in the model law.

The following paragraphs describe in more detail how the Department’s proposal will update Vermont’s regulation of money transmitters to conform with the model law and address the expansion of cryptocurrency in the money transmission space.

Changes to 8 V.S.A. Chapter 72, General Provisions

The general provisions governing the licensing of, enforcement of, and other standard requirements placed upon all licensed financial entities¹ – not just money transmitters – appear in Chapter 72 of Title 8. These provisions were revised and consolidated in 2019 to create consistency in the regulation of such entities. Most of the changes proposed to Chapter 72 will thus impact all licensed financial entities.

All of the changes to Chapter 72 are readily identifiable in the proposed law. The Department's proposal adopts model law language that affects the following key updates and edits to Chapter 72, modifying the language in limited ways to conform with existing Vermont law.² Typographical corrections are also made, which are in addition to the revisions identified below.

8 V.S.A. § 2101 Definitions (and subsequent references to defined terms); 8 V.S.A. § 2103 Approval of application and issuance of license

- Revisions update Chapter 72 to use terminology consistent with terms appearing in the current multi-state licensing software and online platform used by the Department and other states to issue licenses, including money transmitter licenses. In particular the term “control” is clarified and the term “key individual” is added to collectively refer to various individuals at a company who ultimately exercise control and bear some responsibility for the company's actions, terms that can be used regardless of company structure, removing the need to have long lists of named individuals throughout Chapter 72 and removing any doubt of what individuals are subject to review during licensing.

8 V.S.A. § 2102 Application for license

- Revisions codify and clarify a policy that is currently applied by the Department and other states establishing standard requirements for international background reports for individuals who have lived outside the U.S. in the last 10 years.

8 V.S.A. § 2107 Change of control

- Revisions clarify the timing for requests to change the persons or group of persons in control of a licensee, including money transmitters.

¹ These provisions are distinct from the general provisions addressing chartered banks, credit unions, and other similar chartered institutions.

² The Department does not anticipate these minor modifications will create differences between how Vermont and other states regulate money transmitters.

8 V.S.A. § 2108 Notification of material change

- Revisions clarify the timing for notifying the Department of changes to key individuals associated with a licensee, including money transmitters, and clarifies reasons for which Department can disapprove a key individual.

8 V.S.A. § 2019 Annual renewal of license

- Revisions create an automatic expiration date for money transmitter licenses when the licensee fails to pay the annual renewal fee, enabling greater administrative efficiency in the Department's interaction with the multi-state licensing software and online platform used by the Department for licensed financial entities, including money transmitters.

8 V.S.A. § 2115 Penalties

- Revisions establish criminal penalties for a licensee, including a money transmitter, who intentionally provides false information to the Department using language consistent with such penalties for other entities regulated by the Department.

8 V.S.A. § 2127 Networked supervision

- New section providing an express acknowledgement of the Department's collaboration in a multistate licensing process led and organized by CSBS.

Changes to 8 V.S.A. Chapter 79, Money Services

The specific requirements pertaining to money transmitters appear in Chapter 79 of Title 8. Chapter 79 not only establishes specific requirements pertaining to the regulation of money transmitters but also establishes specific requirements for the regulation of check cashing and currency exchange. Because the model law does not address regulation of the latter, Chapter 79 had to be restructured to adopt the model law language, making it appear that far more differences exist between current and proposed law than do. Much of the underlined language appearing in Chapter 79 of the Department's proposal is language that currently exists.

In order to better identify what is changing in the law, this portion of the memo identifies whether each section in the Department's proposal is existing or new as well as key aspects being modified. The subchapters with the key substantive revisions are subchapters 1 (definitions) and 6 (prudential standards) and the all-new subchapter 10 (virtual currency). In addition to the revisions described below, the Department's proposal includes citation updates, typographical corrections, and other similar technical revisions to Chapter 79.

Subchapter 1. General Provisions

Subchapter 1 is repealed and replaced in full. Subchapter 1 contains a few new provisions, such as a provision on the purpose of the law, while retaining and amending existing key provisions which establish definitions and exemptions from licensure.

8 V.S.A. § 2500 Purpose

- New section identifying the purposes for adopting the model law in Vermont.

8 V.S.A. § 2501 Transition period

- New section establishing timeframe for licensees' compliance with amended provisions.

8 V.S.A. § 2502 Relationship to federal law

- New section avoiding conflicts with federal law, particularly to avoid conflicts with new federal laws.

8 V.S.A. § 2503 Definitions

- Existing section revised to add a number of new definitions found in model law, including, among others, definitions of "outstanding money transmission obligations," "payroll processing services," "receiving money for transmission," and a number of terms addressing virtual currency. Other definitions amended to conform with model law. These revisions improve clarity and create greater consistency with other states.

8 VSA § 2504 Exemptions

- Existing section establishing exemption from regulation under Chapter 79 modified for conformity with other states while retaining a few Vermont-specific exemptions. Section remains largely the same in application.

8 VSA § 2504a Authority to require demonstration of exemption

- New section expressly providing Department with authority to require anyone who claims to fall within an exemption to provide documentation of qualification for exemption.

Subchapter 2. Money Transmission Licenses

Subchapter 2 is repealed and replaced in full. It identifies who must obtain a money transmission license, how to apply, and when a kiosk registration is necessarily.

8 VSA § 2505 License required

- Existing section currently located in subchapter 1 relocated and revised only in format for greater simplicity in the text.

8 VSA § 2506 Application for license additional information

- Existing section, with only technical revisions, that identifies information that must be included in applications beyond that required by Chapter 72.

8 VSA § 2507 Money transmission kiosk registration

- Existing provision currently located in subchapter 1 relocated and clarified to include updated application requirements and disclosure requirements currently consolidated with a section addressing bank and credit union ATMs, cash dispensing

machines, and similar machines located in Chapter 200. Revisions allow for greater clarity and specification for the two distinct types of machines, including applicable disclosures such as consideration for transactions involving virtual currency.

Subchapter 3. Check Cashing and Currency Exchange Licenses

Subchapter 3 remains in its current location. It identifies who must obtain a stand-alone check cashing and currency exchange license, establishes requirements for engaging in licensed activities, identifies how to apply, and clarifies which subchapters in Chapter 79 apply to these licensees.

8 V.S.A. § 2515 Check cashing and currency exchange license required

- Existing section, revised only in format for greater simplicity in the text and conformity with § 2505.

8 V.S.A. § 2520 Applicability of subchapters

- New section that clarifies which subchapters in Chapter 79 do not apply to check cashing and currency exchange licensees.

Subchapter 4. Authorized Delegates of Money Transmitters

Subchapter 4 remains in its current location. It establishes requirements for the use of authorized delegates, a person contracted to accept or disburse funds from consumers on behalf of a money transmitter, and specifies the Department's enforcement authority over authorized delegate activity.

8 V.S.A. § 2525 Relationship between licensee and authorized delegates

- Existing section revised to provide greater detail identifying the requirements for the selection and appointment of authorized delegates, including details of their contractual relationship.

8 V.S.A. § 2526 Unauthorized activities

- Existing provision currently located in § 2525 relocated with minor revisions clarifying the liability of authorized delegates that engage in activities on behalf of unlicensed entities.

8 V.S.A. § 2527 Termination or suspension of authorized delegate activity

- Existing section currently located in subchapter 7 relocated, with only technical revisions. Section expressly identifies that the Department can suspend or bar an authorized delegate from acting in such capacity in the state.

8 V.S.A. § 2528 Private actions against authorized delegates

- New section that specifies that civil courts have the ability to grant appropriate equitable or legal relief to a licensee for failure of authorized delegates to remit money in accordance with the contracts between the entities.

Subchapter 5. Reporting and Records for Money Transmitters

Subchapter 5 remains in its current location. The subchapter addresses a variety of reporting requirements for money transmitters.

8 V.S.A. § 2530 Report of condition

- New section that codifies and details existing requirement to provide quarterly reports (“call reports”) with key financial information about a money transmitter’s condition.

8 V.S.A. § 2531 Audited financials

- New section that codifies and details existing requirement to provide annual audited financial statements.

8 V.S.A. § 2532 Authorized delegate reporting

- New section establishing a new requirement to provide quarterly reports about authorized delegates and their activities in the state.

8 V.S.A. § 2533 Change of authorized delegate

- Existing section revised to remove references to notifying the Department about changes in location as the requirement also applies to check cashing and currency exchange licensees and is moved to § 2545.

8 V.S.A. § 2534 Money laundering reports

- Existing section revised to remove the requirement for money transmitters to file federally required money laundering reports with the Department in addition to filing it with the appropriate federal regulatory agencies. To date the Department has not used such reports and, should the Department desire one, can use its authority in Chapter 72 to request it.

Subchapter 6. Prudential Standards for Money Transmitters

Subchapter 6, which currently addresses only the investments a money transmitter is permitted to have, remains in its current location with key provisions currently located elsewhere that also pertain to the long-term financial safety and security of money transmitters, proposed for relocation and consolidation in subchapter 6.

8 V.S.A. § 2540 Net worth

- Existing section currently located in subchapter 2 relocated to subchapter 6 and revised to establish a sliding scale requirement for net worth with the possibility of exemption for good cause; the more assets held by the money transmitter the more net worth (capital) it must maintain at all times.

8 V.S.A. § 2541 Security

- Existing section currently located in subchapter 2 relocated to subchapter 6 that establishes the types of security that must be maintained by a money transmitter at all times and the amount of the security. Surety bond is the most common security.
- Revisions replace a letter of credit as the alternative to a surety bond, an option not typically used, with a deposit that is approved by the Department.
- Revisions establish that the security amount is based on the money transmitter's average daily money transmission liability in Vermont, conforming Vermont's method for determining the security amount with other states, while retaining the same minimum and maximum amount for the security.
- Revisions retain current requirements specifying the language for the surety bond or deposit, identifying the ability of the Department to maintain an action against a bond, and allowing for claims for at least five years after the licensee ceases operation.

8 V.S.A. § 2542 Permissible investments

- Existing section requiring a money transmitter to maintain investments at least equal to its outstanding money transmission obligations and creating a statutory trust for the holders of the outstanding money transmission obligations if certain events occur, like bankruptcy.
- Revisions clarify circumstances when statutory trust is created and require the Department to inform other states when a statutory trust is created, and make technical changes.

8 V.S.A. § 2543 Types of permissible investments

- Existing section identifying the list of investments a money transmitter is permitted to maintain revised for conformity with other states through the removal, addition, and change to the description of particular assets. Changes are not anticipated to have a significant effect as they conform Vermont law with other states' requirements.
- Revisions adds as a permissible investment the amount in a security bond or deposit beyond the amount that exceeds the money transmitter's average daily money transmission liability and a letter of credit that meets specific requirements.

Subchapter 7. Requirements for Money Servicers

Subchapter 7 is repealed and replaced in full with a chapter that consolidates two sections detailing requirements that pertain to both money transmitters and check cashing and currency exchange licensees.

8 V.S.A. § 2545 Change of location

- Existing provision currently located in § 2532a relocated, with only technical revisions. Section requires licensees to notify Department of changes in the location where the licensee or an authorized delegate operate.

8 V.S.A. § 2546 Records

- Existing section currently located in subchapter 5 relocated, with only technical revisions. Section establishes records licensee must maintain in addition to those required via Chapter 72.

Subchapter 8. Conservation, Liquidation, and Insolvency

Existing chapter with only technical revisions.

Subchapter 9. Timely Transmission, Refunds, and Disclosures by Money Transmitters

Subchapter 9 is repealed and replaced in full with a chapter that addresses additional, specific requirements for money transmitters.

8 V.S.A. § 2560 Timely transmission

- New section clarifying a money transmitter's obligation to timely carry out money transmission.

8 V.S.A. § 2561 Refunds

- Existing section currently located in § 2511 relocated, with minor changes to confirm with other states regarding the circumstances in which refunds are required and not required.

8 V.S.A. § 2562 Receipts

- Existing provision currently located in § 2511 relocated and revised to clarify and identify circumstances in which receipts are not required to be provided to consumers, the manner in which receipts can be provided to consumers, the information that must be included on a receipt for money transmission, and when a receipt must provide the information in a language other than English as well as English.

8 V.S.A. § 2563 Notice

- New section requiring money transmitters to provide the Department's name and a link to the Department's complaint form on their website.

8 V.S.A. § 2564 Disclosure for payroll processing services

- New section requiring money transmitters that engage in payroll processing to provide reports to employers and, unless the employer does so, paystubs to workers.

Subchapter 10. Virtual Currency

Subchapter 10 establishes a variety of specific requirements for companies that engage in virtual-currency business activity, including virtual currency exchanges, custodians, seller of virtual currency, and certain virtual currency issuers. Subchapter 10 differs more substantively from the model law provisions on virtual currency. The model law's virtual currency provisions were offered as optional by CSBS rather than final recommendations and are primarily aimed at states not yet regulating companies engaged in the transmission of virtual currency. As the Department has been regulating these companies under the current statutes for over six years the Department's proposal contains changes to the model law language that align it with current Vermont policy and the remainder of the money transmitter requirements in Chapter 79. Included in these changes are a limited number of provisions establishing policies new to Vermont aimed at addressing specific issues regarding virtual currency companies that the Department has observed in its recent regulatory and enforcement efforts.

All of the sections in Subchapter 10 are new.

8 V.S.A. § 2571 Definitions

- Creates virtual currency-specific definitions of "exchange" and "transfer," which cover a variety of methods by which exchanges and transfers of virtual currencies may be affected.
- Note: Many important virtual currency definitions are included in Subchapter 1, including an expansive definition of "virtual-currency business activity" that requires a license (licensees include virtual currency exchanges, custodians, digital wallet services, sellers of virtual currency to the public, and certain virtual currency issuers).

8 V.S.A. § 2572 Exemptions

- Contains a handful of additional exemptions that are specific to virtual currency companies, including exemptions for:
 - certain activities governed by securities and commodities laws, but only to the extent such activities are conducted in compliance with all requirements of such laws;
 - certain data storage and securities vendors to virtual currency businesses;
 - a person using virtual currency solely on its own behalf for personal, family, or household purposes or for academic purposes; and
 - a person whose virtual-currency business activity is reasonably expected to be valued at \$5,000 or less per year.

8 V.S.A. § 2573 Conditions precedent to engaging in virtual-currency business activity

- Prohibits a person from engaging in virtual-currency business activity in Vermont unless a person is licensed by the Department, an authorized delegate of a licensee, or exempt from licensing.
- Prohibits a person from facilitating unlicensed virtual-currency business activity by another person after being notified by a regulator or law enforcement (Paragraph c). It also applies to knowing facilitation of unlicensed activity and to willful ignorance. This provision is based on 9 V.S.A. § 2481w, which prohibits facilitation of unlicensed lending. By notifying service providers to illegal operations, this provision can be used to cut off credit card processing, web hosting and app store support for unlicensed and illegal operators.
- Extends all of the legal requirements under Chapter 79 that apply to a licensed person to any unlicensed person that is operating in Vermont illegally (Paragraph d).

8 V.S.A. § 2574. Required disclosures

- Specifies certain mandatory disclosures that must be made to customers. Among other things, virtual currency licensees must disclose all fees, including hidden markups, and provide certain information in transaction receipts.

8 V.S.A. § 2575 Property interests and entitlements to virtual currency

- Requires that a business that holds custody or control of virtual currency on behalf of customers maintain custody and control of virtual currency in an identical type and amount sufficient to satisfy customer entitlements.
- Specifies that, when a customer deposits a particular virtual currency with a licensee, the licensee cannot satisfy their custodial obligations by holding virtual currency derivatives, digital depository receipts, or non-native “wrapped” or “bridged” tokens (which often carry different security risks and liquidity profiles from native assets). Licensees must hold custody of the exact virtual currencies that their customers deposit or buy.
- Requires that title to all virtual currency be in the name of the customer, and prohibits customer virtual currency from being subject to the liens or claims of a licensee’s creditors.
- Prohibits a licensee from pledging, hypothecating, lending, or otherwise using its customers’ virtual currency. These practices led to the multi-billion-dollar bankruptcies of FTX, Celsius, Voyager, BlockFi, Genesis and others.
- Prohibits a licensee from using an unlicensed custodian to hold customer virtual currency. Entrusting customer virtual currency to unregulated entities is an incredibly risky practice.
- Gives the Commissioner the power to implement additional rules and requirements as may be necessary for consumer protection. Regulatory best practices, technology, and issues of concern are constantly evolving in the virtual currency industry. This

authority will allow the Commissioner to respond to and address emerging issues and threats to consumers.

8 V.S.A. § 2576 Additional requirements and clarifications for virtual-currency business activities

- Allows the Commissioner to establish limitations to, and the method by which, virtual currency and virtual currency-denominated assets can be included in the calculation of a companies' net worth (Paragraph a). This provision is largely in response to the failures of FTX and Celsius, which purported to capitalize themselves with holdings of their own tokens and other speculative cryptocurrencies.
- Requires certain recordkeeping and retention practices (Paragraph b).
- Duplicates the antifraud provisions of the securities laws and applies to any offer or sale of virtual currencies (Paragraph c). The antifraud provisions prohibit a broad array of fraudulent practices that have long been prohibited in securities markets, including misstatements, insider trading, and market manipulation. Although the securities laws already apply to many virtual currencies, this provision allows the Department to take action against fraudsters without first litigating whether the virtual currency in question meets the definition of a "security" under the Vermont Securities Act.
- Requires virtual currency businesses to comply with all applicable states and federal laws, including securities and commodities laws (Paragraph d). A licensee that breaches other laws and regulation applicable to their business will be in violation of this Act and subject to suspension or revocation of their license and other enforcement actions.

8 V.S.A. § 2577 Virtual currency kiosk operators

- To reduce the utility of virtual-currency kiosks to scammers and criminals, limits cash transactions at virtual-currency kiosks to \$1,000 per customer, per day, per licensee. The daily transaction limit is modeled on similar protections adopted by California and other states.
 - Note: Virtual-currency kiosks (often referred to colloquially as "Bitcoin ATMS" or "crypto ATMs") are often employed in frauds and scams. The scammer tricks the victim into withdrawing cash from their bank, purchasing crypto in cash from a virtual-currency kiosk, and sending the virtual currency to a digital wallet address controlled by the scammer. The use of cash and crypto allows scammers to bypass safeguards and delays that exist for transactions effected by credit card or bank transfer.
- Caps the fees that virtual-currency kiosk operators may charge at the greater of \$5 or 15% of the transaction value and requires virtual-currency kiosk operators to

disclose all fees and markups. The fee cap is modeled on protections adopted last year by California.

- Note: Many virtual-currency kiosks charge exorbitant fees, sometimes exceeding 25% of the transaction value. These fees often take the form of undisclosed markups.

Changes to 8 V.S.A. Chapter 200, Consumer Protection

8 V.S.A. § 10302 Automated teller machines

- Existing section that currently applies to money transmission kiosks as well as bank and credit union ATMs, cash dispensing machines, and other similar machines revised to remove money transmission kiosks (which are addressed in Chapter 79 and which include virtual-currency kiosks), allowing for greater clarity and specification for the two distinct types of machines.
- Restructures section to add clarity to application and approval process.