National Pawnbrokers Association

May 9, 2006

Robert W. Werner
Director
Financial Crimes Enforcement Network
P.O. Box 39
Vienna, Virginia 22183

Via email to regcomments@fincen.treas.gov

Re: RIN 1506-AA85 – Advanced Notice of Proposed Rulemaking
On Money Service Businesses

Dear Mr. Werner:

The National Pawnbrokers Association is the only national trade organization serving more than 2,400 members in the pawn industry. Members tend to be small businesses; only a small number of member companies have more than a few stores and only three members of this industry are publicly traded companies. We estimate that our members serve between 20 and 25 million consumers annually. The average loan amount is $60 and the average redemption rate for collateral securing pawn loans is 80 per cent (that is, 80 per cent of customers repay their loans and reclaim their property). Despite stereotypes to the contrary, pawnshops have few problems with stolen property: nationally, our figures reveal that less than 1/10 of 1 per cent of the items securing loans or sold to us are claimed to be stolen property.

Our member businesses often have been in operation for long periods of time, with younger generations succeeding the older ones. They do business in urban and rural locations not well served by commercial banks or credit unions. Their customers generally are middle-class consumers employed in blue-collar fields. The industry has members that serve specialty niches of more affluent customers, particularly in New York City and Los Angeles. Members tend to have long-term relationships with their customers that are more like those that old-fashioned community bankers had with customers than contemporary commercial banks have.

The pawn industry is regulated by federal, state, and local governments. Thirteen federal laws govern the pawn industry, including the USA Patriot Act, the Bank Secrecy Act, provisions of Title 26 of the United States Code pertaining to reporting of cash transactions by those engaged in trades or businesses made on IRS Form 8300, laws, regulations, and Executive Orders enforced by the Office of Foreign Assets Control, Title V (Privacy) of the Gramm-Leach-Bliley Financial Services Modernization Act of 1999, and various other consumer protection laws such as the Truth in Lending and Fair Credit Reporting Acts. IRS field agents examine pawnbrokers' compliance with Titles 26 and 31.

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The Federal Trade Commission has jurisdiction over the industry's compliance with federal consumer protection and other privacy laws and regulations. Finally, federal bank examiners examine those pawnbrokers who offer products through or in conjunction with commercial banks. Some pawnbrokers also have Sarbanes-Oxley compliance responsibilities and SAS 70 standards apply to those who offer products through or in conjunction with commercial banks.

States generally license, supervise, and examine pawnbrokers through the same state agency that charters banks, credit unions, and other non-depositary providers of consumer financial services. Some states place this licensing and supervisory authority in the hands of the agency that handles consumer protection. "Home rule" states tend to leave licensing and examination to local governments. In all cases, local law enforcement agencies regularly review transaction records for members' pawn transactions. These local agencies often receive daily reports of all transactions directly from our members and also conduct spot inspections to be certain that proper records are being created and maintained.

State regulation focuses on prescribing requirements for record-keeping and record retention for every transaction that the pawn stores enters into – both pawn loans and the pawn stores' purchases of used personal property from the general public. In addition, states regulate the terms on which our members' loans and purchases may be made and the disposition of the collateral securing repayment of the debt in the event that the borrower does not repay the loan.

The pawn industry has the original "know your customer" compliance programs. Because of state law requirements originally designed to protect consumers and to enable both consumers and the pawnbroker to identify which item of property belongs to which pledgor, pawnbrokers have been taking sensitive personal information from consumers in conjunction with *every transaction* for decades. Our record-keeping responsibilities are far more extensive than the "customer identification program" requirements of Section 326 of the USA Patriot Act. Pawnbrokers generally must record the customer's address, identification document number, race, date of birth, height and eye color, distinctive physical characteristics, and, in some jurisdictions, a biometric identifier. Pawnbrokers who do not comply with these detailed record-keeping requirements risk the loss of their licenses as consumer lenders and also risk prosecution.

Like businesses that are designated "money services businesses," pawn industry members began experiencing "bank discontinuance" problems in 2004 and discontinuance has continued after FinCEN's March, 2005 hearing and April, 2005 guidance to banks. Some pawn stores provide both pawn and money services, but states separately regulate and supervise these two lines of business. Based on questions that our members receive, some banks do not understand that the pawn business is not part of the larger group of "money services businesses." Pawn industry members have lost longstanding lines of credit as well as demand deposit relationships in most parts of the country since 2004. NPA members saw no particular change of attitude by banks after FinCEN's March, 2005 hearing, after the Acting Comptroller of the Currency's testimony before the House Committee on Banking, Housing and Urban Affairs on April 26, 2005, or after the additional guidance provided by the banking agencies and FinCEN later in 2005, until quite recently.

The pawn industry began experiencing problems with banking relationships shortly after the Office of the Comptroller of the Currency designated "money service businesses" as high risk for money laundering, a decision that we believe was overly broad and not founded on empirical evidence. In addition, recent reports from members and conversations with bankers and FinCEN and IRS representatives suggest that banks may continue to be confused about which lines of business qualify as "money services businesses" and how closely banks must review USA Patriot and Bank Secrecy Act compliance of their customers. We will discuss each issue.

First, the decision to declare all MSB lines of business as risky reflects misunderstanding of the inherent differences among products that fall under FinCEN's definition of "money services businesses." There is no greater risk to commercial banks of check cashers cashing checks than of commercial banks or credit unions taking checks for deposit. The depositor carries the risk that the drawee-payor bank will not pay the check in both cases and the audit trail for the depositor and the bank that takes the deposit will be comparable. This means that banks should focus primarily on whether their own customer is a good credit risk. This essentially requires looking at the way in which the customer has managed the banking relationship, the length of time the customer has been with the bank, and whether there are any out-of-pattern transactions or series of transactions for this customer. Moreover, there is no difference in money laundering risk between a money service business taking a check and a retailer taking a check. The real risk to banks is that the check will prove to be altered, counterfeit, or stolen – risks that every retailer and bank in the United States share in roughly equal measure. Depositors' interests in collecting the checks they take in exchange for products and services mean that depositors have strong incentives to take identification and keep good records, or risk not collecting that money. We also see little difference in risk between a money service business taking cash than, say, of a high-volume McDonald's or a Wal-Mart taking cash.

Second, pawn transactions present no real risks for money laundering or, indeed, for terrorist finance. Consumers who get pawn loans, which as noted above average $60 nationwide, generally *receive the loan proceeds in cash*. In contrast, money launderers tend to wish to *place cash* into the financial and commercial systems, rather than receive cash proceeds. The sheer frequency of such small transactions that would be needed to use pawn transactions to launder money suggests how low the risk of money laundering is.

In addition, because NPA members tend to be loaning their own money, they tend to be conservative about lending in general and require increasing approvals from management for loans larger than approximately $300. Pawnbrokers generally pay proceeds by check or wire transfer only for the largest pawn loans; both of these forms of payment have audit trails that match those available for comparable transactions engaged in by banks themselves.

Ordinary course of business records pawnbrokers are required to keep and that are inspected by our regulators, including local law enforcement agencies, make pawn transactions a highly *unattractive venue* for money launderers who seek to place dirty money as quickly and inconspicuously as possible. The same record-keeping rules apply to items we purchase from the general public. Moreover, the appearance of a new customer with a high-value item, as one might expect from someone seeking funds for a nefarious purpose, would be noticeable to pawn store employees both because the customer was new and in many cases because the merchandise was out-of-pattern for the area the pawnbroker serves. Repeated transactions of high-end items by a new customer would cause more scrutiny of transactions. When someone suspicious comes into a pawn store, or an individual attempts to pawn or sell merchandise with which they are not sufficiently familiar, the owner or manager often calls local law enforcement about the customer. Some cases, of course, would cause one of us to file a Suspicious Transactions Report. Thus, the existing procedures used by pawnbrokers to comply with their existing IRS Form 8300 compliance duties as well as for making the credit or purchase decision makes pawn stores unlikely targets for those looking to launder money or otherwise finance wrongdoing.

Finally, to a lesser extent, we think that some pawnbroker bank discontinuance problems were prompted by efforts by a few consumer groups since 2003 to pressure commercial banks to terminate relationships with businesses the consumer groups labeled as "high-cost" providers of credit. These groups filed comments with federal bank regulatory objecting to some bank holding company or bank applications for acquisitions and mergers on the ground that the banks involved did business with other businesses that charged consumers

more for financial products than banks charged them for credit. The NPA pointed out in comments filed with the Board of Governors of the Federal Reserve System in August, 2004, for example, that these consumer groups' positions were unrealistic because they would require banks to terminate lines of credit for any business who charged its customers more than the businesses' own cost of credit – a set of businesses that includes most sellers of automobiles, jewelry, furniture, home improvement supplies, and consumer electronics. We also noted some other obvious flaws in the groups' arguments – that consumers who finance purchases from retailers generally are higher credit risks, that interest rates for non-depositary providers of credit (retailers and licensed lenders) are set by state laws, that pawnbrokers incur substantially higher transaction costs in terms of record-keeping and item storage than any other lender would for a comparably sized loan, and that retailers and non-depositary providers of credit are entitled under our system to make a profit.

NPA members' reports about bank discontinuance cover local, regional and money center banks in various locations in the country – e.g., Alabama, Florida, Maryland, California, Minnesota, New York, Texas, and South Dakota. The following list presents the scenarios beginning with the most common and ending with the least common scenarios:

- discontinuance of commercial checking accounts, often on only 30 days notice, to customers with relationships more than 10 years old;
- discontinuance of commercial lines of credit, also on short notice;
- discontinuance of pawnbroker by banks specializing in lending to small business because the "MSB paperwork" was expensive so that bank could not make enough money from accounts that had so much government paperwork;
- rejection of applications for commercial real estate loans to buy store sites that explicitly cited the fact that the business would be a pawnshop as the reason for the rejection;
- requirement of a five-figure hypothecated account securing the relationship explicitly because the pawnshop was a "money services business," for a customer with a longstanding commercial checking account;
- rejection of lines of credit for a high-end pawn business in the Northeast by money center banks explicitly because of the alleged "risk" designation of pawn and money services businesses by the Comptroller's Office, although the owners did find a suitable replacement line of credit some months later, and,
- discontinuance of established merchant credit card relationships with pawnbrokers in Maryland explicitly because they were pawnbrokers.

In the vast majority of the cases reported by our members, the member understood that the discontinuance decision had nothing to do with the member's credit standing or management of their account. At least one bank made it clear that it would be pleased to make loans to the pawnbroker in his own name, but that its instructions from higher up in its organization precluded it from loaning money to a pawnbroker.

SouthTrust was one of the regional banks that terminated many pawnbrokers in both Alabama and Florida. Following SouthTrust's acquisition by Wachovia approved in late 2004, Wachovia responded to entreaties by pawnbrokers in both states and agreed to resume doing business with them in late 2005. In addition, quite recently, Compass Bank (operating in Florida and Alabama) approached at least one customer it discontinued about reopening their relationship. More recently, we have been negotiating with another major national company for merchant credit card processing for NPA members.

In addition to these examples of bank discontinuance, we also note that IRS field agents have appeared confused about the differences between requirements under Titles 26 and 31 of the United States Code. Businesses offering diverse consumer financial products covered by both Titles 26 and 31 – such as check cashing and pawn loans, for example – have received inconsistent information about their compliance respon-

sibilities from IRS field agents over the past two years. This was a particularly acute problem in the first two quarters of calendar 2004. Contacts by NPA representatives with FinCEN staff helped resolve the particular problems we were having at the time. This period coincided with loss of banking relationships for members in areas served by new regional examination teams for the IRS. Based on more recent inquiries from members and from banks directed to the NPA, we suggest that there may be room for more training about differing compliance requirements for different product lines for field personnel and for depositary institutions alike.

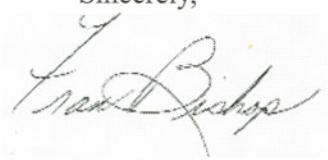
The pawn industry serves millions of middle-class Americans whose short-term credit needs are not served by commercial banks and credit unions. Some of our customers are among the unbanked, a number that the Board of Governors recently estimated as including at least 10 million households. Previous Board of Governors estimates put the number of unbanked persons as being in the range of 30-40 million persons. Our customers often treat their jewelry and other personal property as if they were their credit cards – making draws secured by those items of property when a need for credit arises, repaying them, and generally seeing pawn loans as a more conservative way to control borrowing than credit cards. Others just prefer the friendly atmospheres and more personalized services in NPA members' stores.

In conclusion, we urge FinCEN, its sister agencies under the jurisdiction of the Treasury Department, and other federal bank regulatory agencies to reassess and clarify different levels of risk represented by different consumer financial products offered by depositary and non-depositary institutions alike. We also urge retraining of field examiners so that they will understand the core differences in risks that products may present and can communicate them clearly and effectively both to banks and to non-depositary providers of financial products, such as pawnbrokers.

It is inappropriate to assume that non-depositary providers of financial products and services are inherently more vulnerable to money laundering or to terrorist financing than banks themselves when the agencies lack empirical support for such assumptions. Like banks, pawnbrokers are designated under various federal laws as "financial institutions." The pawn industry has been regulated by the federal government for more than 30 years and by the states for decades. Federal, state, and local governments regularly examine pawnbrokers for compliance with federal, state, and local laws. Finally, it is time to undo the damage to our industry and our customers that abrupt losses of banking relationships caused over the past two and a half years. The pawn industry proudly serves millions of consumers annually who are underserved by commercial banks. Our customers need access to reputable providers of financial products and services. We want to provide those services.

Please contact me if you have questions about our industry or about our comments. We appreciate the opportunity to comment.

Sincerely,



Fran Bishop
President