

Legal Update

California to Clarify Money Transmission Act Exemption Through Rulemaking

On February 8, 2019, the California Department of Business Oversight (“DBO”) announced that it will undertake a rulemaking to clarify the exemption in the state’s money transmitter licensing law for agents of payees.¹ This exemption allows payment agents working on behalf of recipients of funds to receive and remit payments to their principals without being licensed as money transmitters.² Normally, entities that receive money from a person for purposes of transmitting that money to another person are engaged in “money transmission” under the money transmission laws of California and other states.

Background of the Exemption

The agent of the payee (“AOTP”) exemption is an important exemption for merchant payment processors, as well as many fintech companies. It has also been controversial and attracted a lot of scrutiny from regulators—especially the DBO. FinCEN and many state regulators have interpreted the definition of “money transmission” to not include the receipt of money as the payment agent of a recipient—even when the definition did not contain an express AOTP exemption.

In 2003, FinCEN interpreted the definition of “money transmitter” in its own regulations not to cover certain AOTPs.³ In the matter under consideration, the entity operated a service that provided third-party origination services for ACH transactions on behalf of merchants.⁴ Through the entity, merchants could accept customer payments in the form of a checking account debit. The merchants obtained payment instructions from a customer and submitted the instructions to the entity; the entity then batched and submitted the debit information to its bank for processing through the ACH system.⁵ After appropriate authorizations, the entity’s bank would credit the amount to an operating account maintained at the bank by the entity, and, after a holding period, the entity would remit the funds to the merchant.⁶ FinCEN stated that it “does not...interpret the definition of money transmitter to include the [services] that [are] described” by the entity.⁷ FinCEN reasoned that the entity “acts on behalf of merchants *receiving* payments rather than on behalf of customers *making* payments. For th[is] reason, the service that [the entity] provides...more closely resembles payment processing/settlement than money transmission.”⁸

FinCEN extended this reasoning to a bill payment service in 2008.⁹ A gift shop contracted with various utility companies to receive bill payments as the authorized agent of those utility companies. FinCEN concluded that the gift shop was not engaged in “money transmission”:

FinCEN has concluded that a merchant payment processor, processing payments from consumers as an agent of the merchant to whom the consumers owe money - rather than on behalf of the consumers themselves - is not a money transmitter by virtue of such activities. As long as [the gift shop] limits itself to accepting payments only on behalf of the utilities with whom it has contracted as an agent, and declines to accept and transmit funds for any other purpose, [the gift shop]’s activities are sufficiently similar to the services provided to merchants by merchant payment processors for the same conclusion to apply.¹⁰

In 2014, the Texas Department of Banking (“TX DOB”) interpreted the definition of “money transmission” not to include receiving money as a payee’s agent.¹¹ The TX DOB stated that “this is not a statutory exception but rather a function of common law, the effect of which is that the agent is not conducting money transmission.”¹² Specifically, the TX DOB noted that under Texas law it “has been long settled that payment to an authorized agent of a person is payment to the person,” and that this “stems from the general doctrine of agency, which essentially states that whoever acts through another does the act himself.”¹³ The TX DOB then explained why, under this principle, a party that received funds as agent of the payee was not receiving funds for the purpose of transmission:

This doctrine [that whoever acts through another does the act himself] means that

when acting through its agent (the [party receiving funds]), it is the [payee] receiving the funds. As such, if the [party receiving funds] is an agent of the [payee], the [payee] is obligated to the consumer on all funds accepted by the [party receiving funds] within the scope of its agency. In essence, the agency relationship renders the exchange a two-party transaction between the [payee] and the customer. Without receipt of money in exchange for a promise to make it available at a later time or different location, there is no money transmission.¹⁴

However, California’s DBO took the opposite position in response to the same question. The inquiring party asked whether it was engaged in “money transmission” with respect to an arrangement under which the party provided payment services to online merchants that permitted customers of the merchants make purchases through their mobile phones.¹⁵ The inquiring party argued that because each merchant entered into an agency agreement with the party, which explicitly stated that payment made by a customer to the entity is considered the same as payment made directly to the merchant, that no transmission of money takes place.¹⁶ California’s DBO rejected this argument and concluded that “receiving money for transmission” is not defined by the respective liabilities of the parties, and the fact that customer’s liability to the merchant is satisfied when the bill is paid has no bearing on whether money is being received for transmission.¹⁷ California’s DBO stated that a party that receives money as agent of a merchant being paid is “nonetheless transmitting money between the customer and the merchant.”¹⁸ It reasoned that “[the agents] stand as intermediaries between the customer and the merchant, transmitting monetary value between them. The conduct of transmitting money from one person to

another person falls squarely within the meaning of money transmission under the MTA. Thus, any...transactions involving the payee-agent structure require licensing under the MTA."¹⁹

Six months after this opinion, the California General Assembly added an AOTP exemption to the MTA. The exemption provides that the MTA does not apply to a "transaction in which the recipient of the money or other monetary value is an agent of the payee pursuant to a preexisting written contract and delivery of the money or other monetary value to the agent satisfies the payor's obligation to the payee."²⁰ *Payee* is defined as "the provider of goods or services, who is owed payment of money or other monetary value from the payor for the goods or services."²¹ *Payor* is defined as "the recipient of goods or services, who owes payment of money or monetary value to the payee for the goods or services."²²

Since the enactment of the agent of payee exemption, the DBO has issued seventeen public opinions analyzing the applicability of the exemption to various types of businesses. It has specifically confirmed that the exemption applies to certain payroll processing businesses,²³ payment processors operating on behalf of brick-and-mortar and online businesses,²⁴ software that manages periodic or recurring payments to non-employees,²⁵ shipping marketplaces,²⁶ products that allow companies to pay employees or contractors through the employee's or contractor's union,²⁷ digital marketplace platforms,²⁸ and bill payment services.²⁹

However, the DBO has noted that the agency exemption does not apply to prison account pre-payment and advanced deposit wagering programs because the defined terms "payor" and "payee" appear to be available only where a payment obligation for a good or service exists and neither type of program involves a

payment obligation.³⁰ The DBO has also held that entities cannot satisfy the agency exemption where there is no formal contractual relationship between the entity and another entity.³¹

Starting in early January 2018, the DBO began issuing "decline to opine" opinions. In these opinions, the DBO declined to provide inquiring institutions with an opinion on the applicability of the agent of payee exemption because it "intend[ed] to propose a regulation concerning the [exemption] in the near future."³²

DBO's Rationale for Rulemaking

According to the DBO, the AOTP exemption was intended to exempt simple online marketplaces from California money transmitter licensing requirements even though they receive funds from buyers to transmit to sellers of goods and services.³³ Now, the DBO is interested in clarifying how this exemption applies to "longer and more convoluted" payment chains associated with Internet-based commerce.³⁴ Specifically, the DBO's request for comments is based on "several inquiries about whether certain actors qualify as 'payor' or 'payee' and whether certain transactions qualify as 'goods' or 'services' transactions."³⁵

Invitation for Comments

The DBO asks commenters to provide legal authority for their positions and to note the economic impact each interpretation would have on industry.³⁶ Comments are due to the DBO by April 9, 2019.³⁷

The DBO provides a number of specific considerations for commenters in its Invitation for Comments.³⁸ Although DBO provided certain specific questions, stakeholders are not required to provide comments in these areas and are welcome to submit comments not related to them.³⁹

1. Goods or Services

As noted above, the licensing exemption applies to transactions in “goods and services.”⁴⁰ The DBO is requesting comments regarding what items should and should not fall within the term “goods and services.” Specific considerations include the following:

- Whether “goods and services” include assets, rights, interest, or benefits of any kind.
- Whether “goods or services” refer only to the types of items typically found on online marketplaces.
- Are payments in satisfaction of government debts “goods or services?”

2. Payor – Goods

California law defines a “payor” as a “recipient” of “goods.”⁴¹ DBO has asked for comments on the following:

- Whether one “receives goods” only by being an end consumer. In other words, does someone “receive” goods only when they consumer, experience, use, or gift those goods?
- Whether one “receives goods” when they physically receive them but do not actually consume them. For instance, would a retailer who maintains goods in stock be “receiving” those goods for sale?
- Does one “receive goods” merely by receiving title to them? In other words, can someone “receive” goods without actually physically possessing or using the goods?

3. Payor – Services

The defined term “payor” also includes recipients of “services.”⁴² The DBO has asked for comments on the following:

- Whether a commercial entity “receives services” when contractors perform

contractual duties owed to the entity. For instance, would a ride share service “receive” services from a driver who partners with them within the meaning of California law?

- Whether any performance of contractual duties equates to “receiving services.”

4. Other Notable Issues

The DBO also noted that it may allow exemptions from the money transmitter regulation other than those currently provided in statute.⁴³ The DBO asked commenters to describe the full range of commercial transactions to which the agency-based exemption should apply, assuming that it is currently limited to simple, three-party online marketplace transactions.⁴⁴ It also requested draft exemption language reflecting commenters’ recommendations.⁴⁵

Conclusion

The DBO’s historic hostility to the AOTP exemption seems to be thawing a bit. The agency appears to appreciate the inappositeness of money transmitter requirements to payment agents for recipients, as they are fundamentally different than companies that provide money transmission services. Still, the DBO has not yet definitively resolved many key questions about the appropriate scope of the exemption. Parties that seek to rely on the exemption should consider submitting comments to the DBO explaining how their businesses operate and why an agency appointment by the recipient provides protections to parties that make licensing and regulation as a money transmitter unnecessary.

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Endnotes

¹ *Invitation for Comments on Proposed Rulemaking – Money Transmitter Act: Agent of Payee*: DBO (Feb. 8, 2019) (hereafter referred to as the "Invitation").

² Cal. Fin. Code § 2010(l).

³ FinCEN Ruling 2003-08, "Definition of Money Transmitter (Merchant Payment Processor)" (Nov. 19, 2003), https://www.fincen.gov/sites/default/files/administrative_ruling/fincenruling2003-8.pdf. At the time of this ruling, the definition of *money transmitter* in FinCEN's regulations did not include an express exemption for agents of payees. FinCEN amended its regulations to codify the AOTP exemption in 2011. See 76 Fed. Reg. 43,596, 43,586 (July 21, 2011) ("With respect to check cashers and money transmitters in particular, FinCEN has developed a large body of guidance in the years since the issuance of the final MSB regulations in 1999. Similarly, over the years, FinCEN has issued guidance and administrative rulings that provide examples of activities that do not meet the

regulatory definition of a money transmitter, even though entities engaged in such activities may be involved in accepting and transmitting funds. Given the nature and scope of these important interpretative rulings, FinCEN has updated, streamlined, and clarified the MSB regulations in this rulemaking by incorporating and extending these interpretations in the regulatory revisions.").

⁴ *Id.*

⁵ *Id.*

⁶ *Id.*

⁷ *Id.*

⁸ *Id.*

⁹ FIN-2008-R006, "Whether an Authorized Agent for the Receipt of Utility Payments is a Money Transmitter" (May 21, 2008),

https://www.fincen.gov/sites/default/files/administrative_ruling/fin-2008-r006.pdf.

¹⁰ *Id.*

¹¹ Tex. Dep't of Banking, Legal Opinion No. 14-01, "A person providing bill payment services as an agent of the payee is

not engaged in the business of money transmission and does not need a license under the Texas Money Services Act” (May 9, 2014).

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.*

¹⁵ See California Department of Business Oversight, Opinion Letter, Payee-Agent and Factoring Agreements under the MTA (Mar. 3, 2014), http://www.dbo.ca.gov/Laws_&_Regs/dfi_orders_files/2014_MTA_redacted_letter.3.4.14.pdf.

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸

Id.

¹⁹ *Id.*

²⁰ 2014 Cal. Stat. 2209.

²¹ Cal. Fin. Code § 2010(l)(2)

²² *Id.* § 2010(l)(3).

²³ *Opinion Request*, DBO (September 11, 2015), http://www.dbo.ca.gov/Laws_&_Regs/dfi_orders_files/2015_Redacted_Letter_opinion_request_Exemption_91115.pdf.

²⁴ See, e.g., *Opinion Request*, DBO (Feb. 8, 2016), http://www.dbo.ca.gov/Laws_&_Regs/dfi_orders_files/2016/2-8-16%20Redacted%20Letter%20-%20request%20for%20opinion%20re%20exemption%20for%20agent%20of%20payee%20-%20software%20developer%20mr.is.pdf, *Opinion Request*, DBO (Sept. 11, 2015), http://www.dbo.ca.gov/Laws_&_Regs/dfi_orders_files/2015_Redacted_Letter_opinion_request_Exemption_91115.pdf.

²⁵ *Opinion Request – Exempt from Licensure under California Money Transmission Act*, DBO (May 19, 2016), http://www.dbo.ca.gov/Laws_&_Regs/dfi_orders_files/2016/5-19-16%20%20Letter%20Opinion%20Request.pdf.

²⁶ *Id.*

²⁷ *Id.*

²⁸ See, e.g., *Opinion Request – Agent of Payee Exemption*, DBO (Nov. 3, 2016),

http://www.dbo.ca.gov/Laws_&_Regs/dfi_orders_files/2016/11-3-2016%20Opinion%20Letter.pdf, *Opinion Request*, DBO (May 8, 2017),

http://www.dbo.ca.gov/Laws_&_Regs/dfi_orders_files/2017/5-8-17%20Opinion%20Letter.pdf.

²⁹ *Id.* and *Id.*, DBO (Feb. 27, 2018),

http://www.dbo.ca.gov/Laws_&_Regs/dfi_orders_files/2018/Agent%20of%20Payee%20%20Payment%20Processing.pdf.

³⁰ *Request for a legal opinion under Financial Code section 2010(l)*, DBO (Feb. 6, 2018),

http://www.dbo.ca.gov/Laws_&_Regs/dfi_orders_files/2018/Agent%20of%20Payee%20Exemption%20-%20Goods%20or%20Services.pdf.

³¹ *Opinion Request – Exempt from Licensure under California Money Transmission Act*, DBO (May 4, 2016),

http://www.dbo.ca.gov/Laws_&_Regs/dfi_orders_files/2016/5-4-16%20Request%20under%20the%20California%20Money%20Transmission%20Act.pdf.

³² See, e.g., *Request for a legal opinion under Financial Code section 2010(l)*, DBO (Jan. 4, 2018),

http://www.dbo.ca.gov/Laws_&_Regs/dfi_orders_files/2018/Agent%20of%20Payee_Decline%20to%20Opine.pdf.

³³ See *Invitation* at 4.

³⁴ See *Invitation* at 2.

³⁵ *Id.*

³⁶ *Id.*

³⁷ *Id.*

³⁸ *Invitation* at 2-4.

³⁹ *Invitation* at 2.

⁴⁰ *Id.*

⁴¹ Cal. Fin. Code § 2010(l)(3).

⁴² *Id.*

⁴³ Cal. Fin. Code § 2011.

⁴⁴ *Invitation* at 4.

⁴⁵ *Id.*