Client Alert

July 9, 2018

Are You a Money Transmitter in California?

By Sean Ruff and Adam Fleisher

As we have noted on multiple occasions (see here, here and here), one of the most important questions in the non-bank payments revolution — at least from a regulatory perspective — is whether a particular payments service is subject to regulation as money transmission. Almost all U.S. states regulate money transmitters under state-specific licensing regimes, and the statutory definitions of money transmission are quite broad and typically cover any entity that "receives" or "transfers" money.

Money transmission licensing laws were crafted to address companies that sell money orders or stored value products, or offer domestic and international person-to-person funds transfers. However, there are many new companies that function differently: They facilitate the *receipt* of payments by merchants and other payees (including, for example, utilities), rather than facilitate the transmission of funds *on behalf of a sender*. An entity providing this type of service may have a contractual relationship with the recipient under which the entity is appointed as an agent to receive funds on behalf of that recipient (i.e., the payee).

While a handful of states have had long-standing exemptions for entities that serve as an agent of the payee, California was one of the first states to formally address the applicability of a money transmission licensing law to such payments services. In 2014, California passed AB 2209, which created — subject to certain specific criteria being met — a formal exemption from the state's Money Transmission Act, Cal. Fin. Code § 2000 *et seq.* (the "Act"), for an "agent of the payee." *See* Cal. Fin. Code § 2010(*l*). As noted in our prior Client Alerts on this topic, since California's enactment of AB 2209, a number of states also have determined — whether through legislation, regulation, guidance, opinion letter or otherwise — that, subject to certain conditions, state money transmission licensing laws do not apply to services provided as an agent of a merchant or other payee pursuant to a direct contractual agreement.

However, recent developments in California suggest that the scope of what constitutes payee-agency activity exempt from money transmission-licensing may be subject to greater scrutiny. In a number of responses to requests for interpretive opinions, the California Department of Business Oversight (the DBO), which regulates money transmission in California, stated its intent to commence a rulemaking on the "agent of the payee" exemption and its limitations. And, in these communications, the DBO has begun to articulate the types of transactions that it believes would fall *outside* of the payee-agency exemption.

First, the DBO affirmed its belief that the statutory exemption applies only to transactions "where a payment obligation for a good or service exists." In a letter dated February 6, 2018, responding to a request for a legal opinion regarding the payee-agency exemption, the DBO reasoned that it would not, for example, apply in the case of the prefunding of an account, even where the funds are credited immediately to the beneficiary by the entity on whose behalf the intermediary is operating. In this type of situation, according to the DBO, "there is no obligation by the person putting money into the account [i.e., the payor] in the sense that that person is not paying anyone for goods or services."

Building on this opinion, the DBO subsequently indicated, in a letter dated April 5, 2018, that it interprets the payee-agency exemption as providing that no more than one entity can be exempt from licensing as an agent of a payee in connection with a single transaction. According to the DBO, where a marketplace or other ecommerce platform receives funds and settles the funds *to an intermediary* for ultimate settlement to the payee, the platform and the intermediary cannot *both* avail themselves of the agent-of-the-payee exemption.

In reaching this conclusion, DBO started from the premise that only transactions involving the payment for goods or services from a payor directly to a payee would come within the exemption. That is, § 2010(*l*) requires "payment to an agent satisfy the payor's obligation to the payee" for goods or services provided by the payee. And the obligation of the payor — the person purchasing the goods or services from the payee — "cannot be extinguished twice." Thus, if the payor's obligation to a payee (i.e., the seller of the goods or services) is satisfied upon receipt of funds by the platform, then the acceptance of funds by the intermediary from the platform on behalf of the payee "cannot also satisfy the customer's obligation to the merchant [i.e., the payee]."

Given this DBO interpretation, businesses that rely on the payee-agency exemption may wish to evaluate the structure of their arrangements to assess whether they are duly appointed, as set forth in Cal. Fin. Code § 2010(*l*), as an agent of a payee (1) to receive funds (2) from a payor (3) in connection with the payor's obligation to the payee (4) for goods and services provided by the payee (5) to the payor.

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