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VIA EMAIL

Mr. Mark Dyer
Department of Business Oversight, Legal Division
Attn: Mark Dyer, Regulations Coordinator
1515 K Street, Suite 200
Sacramento, California 95814-4052

Re: Invitation for Comments on Proposed Rulemaking Money Transmitter Act: Agent of Payee (PRO 07/17)

Dear Mr. Dyer,

This letter is in response to the State of California Department of Business Oversight's (the "DBO") invitation for comments on proposed rulemaking (the "Invitation"), dated February 8, 2019, regarding the Money Transmitter Act's statutory agent of payee exemption, Financial Code §2010(*l*) (the "Exemption"). PayNearMe MT, Inc. ("PayNearMe") is a licensed money transmitter in the State of California and would like to focus our comments on the questions presented by the DBO regarding the definition of "goods" and "services." PayNearMe believes that a rulemaking that provides clarifying definitions of the terms "goods" and "services," as set forth in § 2010 (l)(1) of the California Financial Code (the "Code"), will eliminate the need to answer the second two questions of the Invitation regarding what constitutes the "receipt of goods" and the "receipt of services."

I. Factual Background

PayNearMe, a licensed California money transmitter, offers a payment processing service (the "Service") that enables participating merchants, billers and creditors (collectively, "Payees") to accept payments from their customers nationwide for the purchase of goods and services. Payments using the Service may be made in person or through the Internet and mobile applications.

II. Legal Analysis and Applicable Law

A. Common law agency principles dictate that statutory agents have the authority to act on a payee's behalf and does not limit this authority to certain transactions.

The act of receiving payment as agent of the payee involves a single event. A consumer conducts a transaction with the payee which involves a payment, and the agent of the payee receives the money for that payment on behalf of the merchant. There is no second event under generally accepted principles of agency law because payment to the agent is deemed payment to the payee. The act of receiving money for the purpose of transmission, on the other hand, involves an additional independent event. First, a consumer sends or delivers money to an intermediary, and the intermediary receives or accepts the money for the purpose of transmitting the money to the consumer's designated recipient. Second, the intermediary transfers the money to the designated recipient on behalf of the customer. When receiving money for the purpose of transmitting it, the intermediary receives and/or holds funds on behalf of the consumer prior to transferring such funds to the designated recipient. On the other hand, under the Exemption the purpose of the transaction is payment by the consumer to the payee, and thus, the transaction begins and ends with payment to the agent, because the agent stands in the shoes of the payee for the limited purpose of effecting the payment from the consumer to the payee. So long as the transaction is not solely for the transmission of money, itself, or per se illegal, there does not appear to be any common law principle that would inhibit what things payors and payees can contract for. Therefore, the same conclusion must be made for the Exemption as the agent has the authority to act on behalf of the payee.

Because of the nature of the agent of a payee concept, which simply holds that payment to the agent is deemed payment to the principle, the specific good or service or other obligation for which the payor is obligated to pay (provided it is legal) is not relevant to the underlying analysis of whether the intermediary has received money for transmission and thus should not be subject to regulation. However, should the DBO determine that a definition is necessary, it should adopt a broad definition as discussed hereafter.

B. Financial Code § 2010 (i) should be interpreted to include within the definition of "goods" and "services" any transaction, other than money transmission itself, that is conducted pursuant to a valid contract between a payor and a payee.

The DBO should promulgate a rule that affirms a broad interpretation of the definition of a "good" and a "service" as set forth in the statute. This definition should incorporate all transactions, with the exception of the actual transmission of money, between a payor and a payee that operate pursuant to a valid contract that establishes an agency relationship between the payor and the payee, whether directly or indirectly. The Uniform Commercial Code (the "UCC") §2-105(1) defines a "good" as "all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale, other than the money in which the price is to be paid, investment securities (Article 8) and things in action." UCC §2-105(2) goes on to say that the goods must be both "existing and identifiable at the time." In other words, according to the UCC, a good must be a thing, other than the money used to purchase the thing, that is identifiable and movable at the time of sale. The UCC does not try to create an exhaustive list of goods that can be contracted for, nor do they set limits on the types of things that could be considered a good under the UCC. This is because trying to create a specific definition of all items that could be considered a good would be an exercise in futility, as new goods are constantly being created and would require an ever-changing list of approved goods. A good is simply a movable, tangible thing that has value and can be contracted for.

The Invitation uses the example of Amazon and other online e-commerce marketplace platforms as being exempt from money transmission services. This categorization is aligned with PayNearMe's proposed definition of goods because in both cases, the "good" itself is not defined. Rather, the determination relies on the fact that the marketplace can only allow the purchase of goods. With the exception of illegal goods, Amazon, itself, has not attempted to create a static list of items that are approved for sale on its platform. Also, similar to the Exemption at issue, Amazon is presumably accepting funds from a consumer on behalf of the merchant that has an agreement with Amazon, while the consumer obtains the "good" from Amazon. The key element in this is that the agreement for purchase is between the payor and payee; and neither money, nor the transmission of money, is the thing being purchased.

The concept of "services" is established by the common law, and is not defined by the UCC. Thus, the DBO should look to the common law and other sources, and should embrace a broad and inclusive definition of the "services." For instance, Black's Law Dictionary defines a service, in relevant part, to include "being employed to serve another; duty or labor to be rendered by one person to another." Here, again like we saw with "goods", we see the term "service" defined to be inclusive and retain the ability to expand as a service evolves. Additionally, as illustrated with "goods", so long as the service is legal and not a payment for the transmission of funds, the contract between the payor and the payee should be indicative that the action being performed or withheld is a "service."

For example, the Invitation cites Airbnb as a "clear" example of a marketplace that is exempt from money transmission. Since Airbnb is not selling tangible goods like you would find on Amazon, it must be an example of a service. Airbnb defines themselves as a company that "leverages technology to economically empower millions of people around the world to unlock and monetize their spaces..." In other words, Airbnb is an online platform that enables property owners to advertise their properties so that consumers can purchase temporary lodging from them. Based on public representations, Airbnb appears to act as the payments intermediary between the parties to enable payment for this arrangement. Importantly, however, what buyers on the Airbnb platform obtain from sellers is not a good or a service as strictly defined. Instead, it is more akin to a lease. In this regard, Black's Law dictionary defines a lease as, "A conveyance of lands or tenements to a person for life, for a term of years, at will, in consideration of a return of rent some other recompense." Based on the product that Airbnb markets and the definition of a lease, specifically the "at-will" portion, it would seem difficult to delineate how Airbnb's payments services could come within a narrow, literal definition of goods and services. And, it would also be difficult to distinguish Airbnb's payments services from other payments services associated with transactions that extinguish a payor's liability to a payee for something other than a tangible good or a service. For example, if payments for short-term rentals through Airbnb are exempt under § 2010(*l*), there is no good reason for long-term residential housing, such as a mortgage or lease payment to be treated differently under the statute. Both entail payments that extinguish a payor's obligation to a payee, but may not necessarily constitute a payment for a good or a service. The only difference is with whom the contract for the lease of property is with, Airbnb contracts with the property owner or property group on behalf of the consumer; where in a residential housing the agreement is typically made by the lessor directly with the landlord. Nevertheless, it is the contract that is the important part, not what the contract is for (short term or long(er) term lodging).

Based on the above definitions and examples, it would seem arbitrary and quite burdensome for the DBO to enumerate each type of "good" or "service" that meets the Exemption. Instead, the DBO should adopt a definition of "goods" and "services" that includes all transactions, not including money transmission itself, that operate pursuant to a valid contract between a payor and a payee.

C. <u>From a policy perspective, a broader definition of "goods" and "services" does not inhibit the DBO's goal of consumer protection or the prevention of money laundering.</u>

Key purposes of regulating money transmission include consumer protection, safety and soundness, and prevention of money laundering. In this regard, the DBO's intent inherent in Chapter 1 Section 2001-2002 of the Code is to "(a) Protect the interests of persons in this state who use money transmission services. (b) Provide for the safe and sound conduct of the business of licensees. (c) Maintain public confidence in licensees." Similarly, the prefatory note to the Uniform Money Services Act ("UMSA"), drafted by the National Conference of Commissioners on Uniform State Laws, provides that the goals and objectives of the UMSA include promoting safety and soundness, and deterring money laundering. By contrast, the Department of Treasury Financial Crimes Enforcement Network ("FinCEN"), which regulates money transmitters, has promulgated regulations intended to protect against the risk of money laundering (as opposed to addressing safety and soundness concerns).

The policy objectives of these regulatory regimes are not implicated by agent-of-a-payee transactions. From the safety and soundness perspective, no funds are held by the intermediary on behalf of the payor, and thus no payor funds are at risk. This is because of the common law principle that payment to an agent is payment to the principal—the agent acts in place of, and on behalf of, the principal. This principle holds in any arrangement in which an intermediary is a duly appointed payments agent of a principal pursuant to a written agreement, and thus the policy imperative of money transmission regulation is absent in any transaction in which the agent receives payment on behalf of a payee that extinguishes the payor's obligation. The nature of the underlying obligation does not matter; what matters is payment to the intermediary extinguishes the payor's obligation to the payee. The common law agency principle underlies the Exemption, as well as the similar exemptions from licensing in other states' money transmission licensing laws. In addition, from the anti-money laundering perspective, FinCEN has affirmed that payment processing transactions are not subject to regulation under the BSA where the intermediary "[a]cts as a payment processor to facilitate the purchase of, or payment of a bill for, a good or service through a clearance and settlement system by agreement with the creditor or seller."[1] FinCEN has reasoned that these types of transactions are "a

[1] 31 C.F.R. § 1010.100(ff)(5)(ii)(B).

relatively controlled flow of money that poses little money laundering risk, provided that the funds are transmitted only to the creditor or seller with whom the payment processor has contracted and not to another location or person."

1. <u>Defining a set list of approved "goods" and "services" does not serve to further protect consumers.</u>

PayNearMe believes that the statutory language of the Code, demonstrates that the legislative intent in defining "money transmission" was to regulate persons offering services that involve a risk of loss to consumers. California consumers do not need additional statutory protections like the net worth, surety bonds and permissible investment requirements when a business is providing payments services as an agent of a payee because there is no incremental risk to the payor due to the involvement of an agent in processing payments on behalf of a payee. From the perspective of the consumer, the payment is deemed made to the payee when made to the payee's agent. Once the consumer's money is delivered to the agent, the transaction is complete. Any outstanding obligation a consumer has to the payee is extinguished both legally and contractually once the money is received by the agent by virtue of the agency relationship between the agent and payee. The protections of the money transmission law only make sense where the intermediary receives funds on behalf of the *payor* and has an obligation to deliver the funds as per the payor's instructions, such as when a licensee receives funds form a consumer and delivers the consumer's funds to the consumer's designated beneficiary.

2. <u>Defining a set list of approved "goods" and "services" does not serve to decrease the risk of money laundering.</u>

When operating pursuant to the Exemption, there is an extremely low money laundering risk because the agent is accepting payment on behalf of the known payee. First, the payee has entered into contractual relationship with the agent and the agent is accepting payment for the particular transaction pursuant to the payee's business. Secondly, as an industry best practice, the agent has conducted due diligence, onboarding, and other applicable checks on the payee pursuant to the contracting process. Lastly, by virtue of being in the flow of funds, and as best practice, payee-agents develop their own AML policies. For example, the agent will implement due diligence requirements, vendor onboarding procedures, set transaction limits, and establish transaction monitoring systems. Under the Exemption, a consumer does not send money to another person, rather a consumer is paying someone (typically a business) for something (any good or service that is not itself money transmission). So long as the contract between the payor and the payee is legal and the agent is accepting payment for the purchase of something other than the transmission of money, there is a low risk of money laundering. Limiting what payors and payees can contract for under the Exemption will not further decrease the already low risk of money laundering.

III. Conclusion

PayNearMe believes that the DBO should adopt a broad and general definition of "goods" and "services" in its forthcoming rulemaking that includes all transactions, not including money transmission itself, that operate pursuant to a valid contract between a payor and a payee. Should the DBO attempt to define an enumerated list of approved "goods" and "services" they will set themselves for an extensive, and endless, debate on what should be included on that approved list. Instead, the DBO should focus on the underlying policy basis for the exclusion of agent of a payee transactions, which is that payment to the agent is deemed payment to the principle and, therefore, the payor's obligation to the payee is extinguished upon receipt by the agent. The common law agent of a payee principle holds regardless of whether the payor is paying for a physical good such as a television or paying an obligation such as a mortgage payment. Any list of goods or services that come within the exemption would arbitrarily reduce the power of an agent to operate on behalf of the payee operating under a valid contract with the payor, which is a fundamental common law tenet, and not conditioned on the nature of the payor's obligation to the payee

Regards,

Connor McNulty

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cc: Lauren Brown, VP of Legal, Handle Financial, Inc.

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