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VIA ELECTRONIC MAIL
State of California
Department of Business Oversight, Legal Division
Attn: Mark Dwyer, Regulations Coordinator
1515 K Street, Suite 200
Sacramento, California 9581-4052
regulations@dbo.ca.gov

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

Ladies and Gentlemen:

Schwartz & Ballen LLP is pleased to submit this comment letter to the California Department of Business Oversight ("DBO") regarding its proposed rulemaking on the "agent of the payee" exemption from the California Money Transmitter Act under California Financial Code § 2010(l). Our law firm represents numerous traditional and Fintech-focused money transmitters licensed in California, as well as other e-commerce companies whose products and services utilize the U.S. banking and payment systems.

We appreciate the DBO's efforts to ensure its formulation and guidance on the application of the "agent of the payee" exemption under Financial Code § 2010(l) remains relevant and is applied in a fair manner as payment processing technology continues to evolve. We have followed the development of the agent of payee exemption since its inception in Assembly Bill 2209 (2014) in California and in the 16 other states which expressly recognize similar exemptions.[1]

We believe the California exemption, as currently formulated, reflects the intent of the California legislature (the "Legislature") to focus on the contractual formation of the agent-payee relationship and satisfaction of the payor's obligation upon delivery of the money or monetary value to the agent as criteria for establishing eligibility for the exemption. Further, the Legislature clearly indicated its intent to interpret the exemption broadly. Accordingly, we encourage the DBO not to restrict and to keep the framework of the exemption flexible, and to continue to support innovative ways new payment processing technologies and relationships may evolve.

[1] In addition to California, the following states expressly recognize an exemption for agents of payees or payment processing conducted on behalf of merchants/sellers of goods or services via law, regulation or department policy or staff interpretation: 1) Idaho, 2) Illinois, 3) Kansas, 4) Kentucky, 5) Michigan, 6) Nebraska, 7) Nevada, 8) New York, 9) North Carolina, 10) North Dakota, 11) Ohio, 12) Pennsylvania, 13) Texas, 14) Virginia, 15) Washington, and 16) West Virginia (to be effective June 7, 2019). The Financial Crimes Enforcement Network ("FinCEN") of the U.S. Treasury Department also recognizes an exemption from the definition of a "money transmitter" under the Bank Secrecy Act regulations for payment processors meeting certain criteria.

I. The Legislature Focused the Qualifications for the Exemption on the Creation of an Agency Relationship; Adding Any Additional Criteria To Qualify for the Exemption Would be Contrary to the Statutory Text and Intent of the Legislature.

When crafting the exemption, the Legislature focused solely on the creation of the agency relationship, namely through a written contract, and satisfaction of the payor's obligation to the payee upon delivery of the money or monetary value to the agent. Although the Legislature had the opportunity and did define other terms used in the statutory provision, it chose not to focus on what does or does not constitute "goods" or "services" for which payment is being rendered to the agent under the exemption. Accordingly, in accordance with statutory construction principles, we believe the statutory language should be taken on its face and the Legislature intended the terms "goods" and "services" as used in the exemption to be interpreted broadly.

First, the fulcrum of Financial Code § 2010(l) to establish the agency relationship is whether the entity in question "is an agent of the payee pursuant to a preexisting written contract." The term "agent" is defined broadly in Financial Code § 2010(l) by reference to Cal. Civil Code § 2295 as "one who represents another, called the principal, in dealings with third persons." This broad and unqualified definition of "agent" in Financial Code § 2010(l) is consistent with and supports the conclusion that Financial Code § 2010(l) is not limited to any particular type of good or service or goods or services sold in a particular manner.

We note that the requirement under Financial Code § 2010(l) that there be a "pre-existing written contract" establishing the requisite agency relationship does not require that such written contract be a two-party agreement between the entity in question and the payee. Accordingly, we believe all types of written contracts establishing the requisite agency relationship would satisfy this requirement, including a written contract with another agent or other person or entity acting on behalf of the payee or a written contract agreeing to payment network rules establishing this agency arrangement.

Second, the Legislature established that the delivery of funds to the agent in satisfaction of the payor's obligation to the payee is necessary to qualify for the exemption. Although the Legislature had ample opportunity to define "goods" and "services" at the time it defined "payor," "payee" and "agent", it did not do so, nor does the statute's legislative history reflect an intent to define such terms. Accordingly, using applicable methods of legislative interpretation, we must assume that the Legislature intended for "goods" and "services" to have their usual meanings.[2] Therefore, the basis the DBO may use to create restrictive definitions of such terms is

[2] *FCC v. AT&T Inc.,* 562 U.S. 397, 405 (2011) ("When a statute does not define a term, we typically 'give the phrase its ordinary meaning.'") (citing *Johnson v. United States*, 559 U.S. 133, 138 (2010)); *In re Rojas,* 23 Cal. 3d 152, 155 (1979) ("In engaging in statutory interpretation we are to accord words their usual, ordinary, and common sense meaning based on the language the Legislature used and the evident purpose for which the statute was adopted."); *Leroy T. v. Workmen's Comp. Appeals Bd.*, 12 Cal. 3d 434, 438 (1974) ("'[T]he meaning of a statute must, in the first instance, be sought in the language in which [the statute] is framed, and if that is plain . . . the sole function of the courts is to enforce it according to its terms . . . One who contends that a provision of an act must not be applied according to its natural or customary purport of its language must show either that some other section of the act expands or restricts its meaning, that the provision itself is repugnant to the general purview of the act, or that the act considered in pari materia with other acts, or with the legislative history of the subject matter, imports a different meaning."') (citations omitted).

unclear, given the Legislature decided to not define them and the statute's legislative history does not show an intent to define them.

The exemption in Financial Code § 2010(l) generally references "goods or services." The statute does not limit the exemption to any particular type of good or service. Similarly, the definitions of "payor" and "payee" in Financial Code § 2010(l) require only the payment of money or other monetary value for the goods or services, and do not limit in any way the goods or services which are the subject of that payment.

We believe the foregoing evidences the Legislature's intent that the exemption be interpreted broadly, to goods and services as those terms are used in the normal public discourse. The terms "goods" and "services" are generally understood to refer to virtually all types of goods or services and are not understood as limited to a particular type of good or service or a good or service sold in a particular manner.[3]

Moreover, in comparison to other states, the New York, Nevada, Ohio and Texas agent of the payee exemptions referenced in the legislative history of Cal. Fin. Code § 2010(l) are not limited to certain types of goods or services or goods or services sold in a particular manner.[4] Indeed, none of the other 12 states recognizing such exemptions have limited the exemptions to certain types of goods or services or goods or services sold in a particular manner.

II. No Public Policy Purpose Would be Served by the DBO Further Defining the Instances in Which the Exemption May Apply, and the Basis the DBO Would Have for Doing So is Unclear.

No public purpose would be served by the DBO promulgating a regulation to define (and thus inherently limit) the transactions to which the exemption may apply. Further, there is no need for the DBO to do so. The relevant transactions are not high risk from a consumer protection standpoint. The Legislature's formulation of the criteria to qualify for the exemption underscores that these transactions are low risk for the payors because the payors received the good or service paid for (whatever that good or service might be), and their obligation has been discharged once the payment is delivered to the agent. Neither are they high risk from a money laundering perspective.[5]

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[3] Article 2 of the Uniform Commercial Code, which has been adopted by the State of California at Cal. Com. Code § 2105.

[4] Nev. Rev. Stat. § 671.040(2); N.Y. Banking Law § 641(1); Ohio Rev. Code Ann. § 1315.01(G); 7 Tex. Admin. Code § 33.4.

[5] FinCEN, Definitions and Other Regulations Relating to Money Services Businesses, 76 Fed. Reg. 43,585, 43,593 (July 21, 2011) (in explaining the rationale for excluding payment processors from the definition of a money transmitter, FinCEN stated: "A payment processor could not provide the primary service of coordination without providing ancillary money transmission services, but because the money transmission services are ancillary, *and because they are generally low risk*, it is appropriate for entities engaged in this activity to be excluded from the definition . . . [a] *contractual agreement for transmission services between the creditor or seller and the money transmitter is a 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.") (citations omitted) (emphasis added).

We further do not believe any circumstances have changed since the exemption was enacted that provide a public policy justification for the DBO to further define the terms used in the exemption, which could have the inapposite effect of limiting the exemption. Depending on the payment method used by the payors, the payors may have dispute rights with the issuer of their payment method or account under federal law and regulations or by private agreement between their issuer, merchants, and other entities participating in the payment networks. For instance, the payor has dispute rights for purchases with debit cards, via ACH transactions, or prepaid accounts, under the Electronic Fund Transfer Act and federal Regulation E;[6] for purchases with credit cards, under the Truth in Lending Act and Regulation Z;[7] and in the case of any branded (Visa, MasterCard, Amex, Discover, etc.) debit, credit or prepaid card, under payors' agreements with their issuing banks implementing the protections and dispute processes (in addition to applicable law) provided for under the applicable card network's rules.[8] Such protections existed for buyers at the time the statute was enacted and remain in place today. Indeed, since the statute's enactment, additional protections have been implemented for payors utilizing prepaid accounts through the newly effective Regulation E provisions.[9]

Further, we do not believe there are any risks on the payee side of the transaction which are not already addressed in the course of normal business relations. On the payee side of the transaction, any issues which may arise with respect to the obligation of the agent to remit the transaction proceeds to the payee should be a commercial matter resolved between the parties, as is the case with any other sale of goods or services, and therefore the State should not interfere in such matters. In any case, given the agent's status as an agent of the payee, the payee should have recourse to the agent (and potentially other parties other than the payor involved in the processing of the payment depending upon the specific arrangement) if the agent fails to remit the proceeds to the payee.

III. It Would Go Beyond the Statutory Text and Legislative Intent to Interpret the Exemption to Solely Apply in a Marketplace Context, Rather the Exemption Should be Applied Broadly.

We are concerned that the DBO's rulemaking appears to focus on "marketplaces," which bring together buyers and sellers of goods or services on one technology platform. While we agree that the exemption was intended by the Legislature to apply to marketplaces, we do not believe based on our review of the text of the statute and its legislative history that marketplaces were intended to be the sole beneficiaries of the exemption.

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[6] 12 C.F.R. §§ 1005.6; 1005.11.

[7] 12 C.F.R. §§ 1026.12(b), (c); 1026.13.

[8] *See, e.g.*, Visa Inc., Core Rules and Visa Product and Service Rules, Rules 1.4.6 (Zero Liability); 4.1.13 (Provisional Credit/Zero Liability); 11 (Dispute Resolution) (Oct. 13, 2018), *available at:* https://usa.visa.com/dam/VCOM/download/about-visa/visa-rules-public.pdf; Mastercard Incorporated, Transaction Processing Rules, Rule 6.3 (Limitation of Liability of Cardholders for Unauthorized Use) (Dec. 18, 2018); MasterCard Chargeback Guide (Dec. 2018); *available at:* https://www.mastercard.us/en-us/about-mastercard/what-we-do/rules.html.

[9] 12 C.F.R. § 1005, Subpart A; 81 Fed. Reg. 83934 (Nov. 22, 2016); 82 Fed. Reg. 18975 (Apr. 25, 2017); 83 Fed. Reg. 6364 (Feb. 13, 2018).

Turning to the legislative history, upon the introduction of AB 2209, our understanding is that the exemption was intended to apply broadly to third parties facilitating payment for the purchase of goods or services from another. Online marketplaces were simply one example cited by the Assembly and Senate legislative committees reviewing the proposed exemption of how a third party may facilitate the purchase of goods or services from another. Relationships with vendors were another example cited in both the Assembly Committee on Banking and Finance (ACBF) bill analysis (4/28/14) and Assembly Floor Analysis (8/4/14). In this regard, the ACBF analysis (4/28/14) recognized that:

> AB 2209 clarifies that money transmission does not include a transaction in which the recipient of the payment (currency or other value) is an agent of the payee and delivery of payment satisfies the payor's obligation to the payee. What does this mean in less complex terms? ***Many entities may use third parties, or due to their relationship with vendors may themselves be third parties that provide payment facilities for the purchase of goods or services***. ***For example,*** a consumer goes to an online marketplace to purchase an item. To the consumer, it may appear from all visible evidence that the online marketplace is both providing the item and accepting the payment for the item. On the contrary, the item is provided by a third party merchant, potentially unseen by the consumer. In this scenario, the consumer's payment obligation and potential future warranty, return, or exchange issues are the responsibility of the online merchant, not the third party merchant. ***In this example,*** under a broad interpretation of the literal meaning of the statute the transaction could be considered money transmission activity. AB 2209 clarifies, through the use of the 'payee' and 'agent' language that online marketplace transactions are not money transmission. (*emphasis added*).

The same text as above is repeated in the Assembly Floor Analysis (8/4/14). The Senate Banking and Financial Institutions Committee (June 18, 2014 hearing on the bill, as amended June 9, 2014) also recognized that:

> **Many goods and services are exchanged with the assistance of third parties, particularly over the Internet. For example**, if a consumer visits an online marketplace such as Amazon.com, iTunes, or eBay to purchase an item, he or she is often purchasing from the merchant or artist listing their good or service on the marketplace, not from the operator of the marketplace. **In this scenario**, the consumer's payment obligation is to the ultimate recipient of the payment, and not to the third party intermediary. AB 2209 would amend the MTA to provide that the third party **in these examples** is not required to be licensed as a money transmitter, as long as the third party has an agency relationship with the seller, and as long as the money sent to the third party by the buyer satisfies the buyer's obligation to the seller. According to the author's office, four other states, including New York,

> Nevada, Ohio, and Texas, have added a similar 'third party agent' exemption to their money transmission laws. (*emphasis added*).

Accordingly, we believe the Legislature's intent is clear from the legislative history that it wished the exemption to apply broadly to third parties facilitating payment for the purchase of goods or services, not solely to marketplaces. The DBO should therefore move cautiously in promulgating any regulations and ensure they do not narrow application of the exemption to exclude possible technology platforms, offline interactions, or other means by which parties may enter into a payee-agent relationship. Again, we believe the fulcrum of the exemption as enunciated by the Legislature is the establishment of the agent-payee relationship by written contract and, as would be expected in an agency relationship, satisfaction of the payor's obligation by delivery of payment to the agent; not the type of good or service that is the subject of the transaction or the manner by which the good or service is sold by the payee to the payor.

IV. In View of the Continued Evolution of Technological Advances in the Money Transmission and Payments Industries, We Caution the DBO Against Restricting the Application of the Exemption Via Rulemaking.

The framework established by the Legislature is flexible and has adapted to legitimate uses of the exemption. We believe this flexibility is critical in order to promote development of new payment technologies and to not restrict innovation in the State of California. Companies located in the State of California lead not just the nation, but the world, in the ongoing payments technology revolution.

As neither we nor the DBO can predict how payment processing technology and initiatives such as the Federal Reserve's Faster Payments Initiative[10] and similar private industry initiatives[11] will evolve in the future, we believe it prudent to not limit the exemption's use in terms of qualified parties or qualified transactions through this rulemaking. Doing so runs the risk of inadvertently stifling technological or other initiatives which otherwise would occur in the absence of the exemption limitation.

If the DBO wishes to state *examples* of agency relationships or transactions which qualify for the exemption, that is certainly useful to reduce confusion in the industry. However, we do not believe it would be useful, and potentially harmful to innovation in the State of California, for the DBO to narrow or place limits on what relationships or transactions will qualify for the exemption via this rulemaking.

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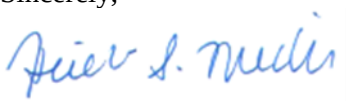
[10] *See* The Federal Reserve, FedPayments Improvement, https://fedpaymentsimprovement.org/.

[11] *See* The Clearing House, Real Time Payment (RTP®) Network, https://www.theclearinghouse.org/payment-systems/rtp/institution; NACHA—The Electronic Payments Association, Same Day ACH, https://www.nacha.org/rules/same-day-ach-moving-payments-faster-phase-1.

Thank you for your consideration and review of Schwartz & Ballen LLP's comments. If you have any questions or wish to discuss this letter, please do not hesitate to contact me as indicated above.

Sincerely,



Heidi S. Wicker
Partner

cc: Jennifer Rumberger, Senior Counsel, DBO
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