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Sent Via Email – 4/8/19

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Dear Ms. Rumberger and Mr. Dyer,

The Third Party Payment Processors Association (TPPPA) is grateful for the opportunity to provide comment to the Department of Business Oversight with respect to the proposed rulemaking regarding California's Money Transmitter Act (MTA) concerning the agent-of-payee exemption. The TPPPA is an industry association formed in 2013 whose members include payment processors and financial institutions that sponsor payments into the various payment systems. The TPPPA has created industry best practices for payment processors and financial institutions through the TPPPA Compliance Management System (CMS). The CMS consists of a control framework that supports both member classifications in creating risk-based, documented compliance management programs for payment processing that are tailored to the unique requirements and responsibilities of the members' distinct payment processing programs. The CMS is designed to support all forms of payment processing (e.g. ACH, Card, Check) and was created to address the oversight of state and federal regulatory agencies, including the FDIC, OCC, FRB, CFPB, FTC and FinCEN.

The TPPPA and its members appreciate the important role that states play in protecting their consumers, supporting small business, promoting safe and responsible innovation, and promoting competition. The State of California plays an important leadership role in the financial services industry generally and with payments specifically. This leadership role is underscored by the fact that 12% of the consumer population resides in California. As a result, the decisions that California makes related to the MTA will have a significant impact to the payments industry and the TPPPA membership.

Because of California's important role with respect to payments, we urge the Department to make it clear that the agent-of-payee exemption is to be construed broadly in a manner consistent with the goal of "not creat[ing] unnecessary barriers to entry for new entities wishing to enter the payments space."[1]

[1] California Committee Report, 2013 California Assembly Bill No. 2209, California 2013-2014 Regular Session (August 13, 2014).

## A. Payment Processors and Their Role in the Payments Ecosystem

Payment processors are technology companies that enable other companies to provide electronic payment processing services to their customers. Payment processors are most commonly small-to-midsized businesses that offer these services to other small-to-midsized businesses, government entities and nonprofit organizations. Payment processors often take on the credit[2] and technology[3] requirements for processing payments directly through a sponsoring financial institution.

Without payment processors, many of these small-to-midsized businesses would not qualify for electronic payment processing services and lose the ability to compete with larger companies that have the financial and technological capacity to process payments directly through their own financial institution. Many payment processors have been processing payments for decades, with long-standing relationships with their partner financial institutions and the small business companies that they serve. They provide a more personal touch in relationship management than the very large payment processors, and generally offer better pricing, which benefits small business and ultimately consumers. Payment processors offer industry expertise and support to small businesses which is not generally available from the large payment processors.

In a typical scenario, a customer (most often a consumer, a business, a donor or an employer) will initiate a payment, or batch of payments online or through a mobile application, to a merchant, another business, an employee, a government agency or nonprofit organization. The payment data is actually transmitted to the payment processor. The primary role of the payment processor is to collect payment data and properly format payment instructions to the requirements of the applicable payment system in order to facilitate straight-through electronic payment processing. The information that the payment processor receives in the form of payment instructions is generally limited to information about the payment. This information is the financial institution routing number, account number, type of payment, amount of the payment, and whether the transaction is a debit or a credit. The payment processor will then forward these payment instructions to the financial institution that is sponsoring the payments into the payment

[2] Financial Institutions require companies that originate payments through them to be in financial good standing (i.e. credit worthy) as the financial institution is ultimately responsible for the return of funds based upon the warranties it provides under the payment system rules. The financial institution is debited for any returned payments, such as standard returns (e.g. insufficient funds, stop payments, account closed), and unauthorized returns and/or chargebacks initiated by the person making the payment. Standard returns generally have a two-day return window, but unauthorized returns and chargebacks, particularly from consumer accounts, have extended return timeframes through the payment systems in alignment with Regulation E, Regulation CC and private network rules (e.g. Visa, Master Card, NACHA, ECHHO.) Payment system warranties for these returns are always directly with the sponsoring financial institution. Warranty claims can be made against the financial institution well beyond the timeframes allowed through the payment systems. The financial institution needs to have the ability to be reimbursed for these returns and will seek reimbursement directly from the payment processor rather than from the originator of the payments.

[3] Each payment system/network, (e.g. Card, ACH, Check) has its own set of rules and technical requirements that must be met in order to facilitate straight-through automatic payments. Each of the payment system has its own exact data set requirements for the formatting of the electronic records and files that contain the payment instructions. There are also multiple data sets for the variety of different types of transactions that flow through the payment networks. Each data set is distinct to align with the payment system rules for different types of payment, (e.g. payments authorized over the telephone, payments authorized over the internet, payments authorized at the point of sale,) because the legal and regulatory requirements (e.g. Regulation E) that are built into the payment system rules require that each payment be properly identified in order to apply the applicable rules. Additionally, payment systems have data security requirements for proper handling and storage of non-public personal information, such as account number and financial institution routing information.

system[4], who will forward the payments to the payment system operator.[5] The payment instructions, which are associated with the settlement of the funds transfers between financial institutions, are also provided to facilitate the automated posting of accounting entries to the financial institutions' respective customers. Payment processors facilitate the transfer of data. Financial institutions facilitate that transfer of funds.[6]

One of the stated primary objectives of the MTA is to protect consumers[7] and the standards that apply to payment processors achieve this objective. Each of the payment systems provide protections to consumers that allow consumers to reject unauthorized or improper payments. This is facilitated through the extended return timeframes in ACH, that align with the requirement of Regulation E (which also applies to debit card payments.) The NACHA[8] Operating Rules even allow the consumer to return payments as unauthorized for incomplete transactions, where the company that the consumer is paying did not receive the funds from the payment processor after settlement. Card holders have the ability to chargeback unauthorized or improper payments. Consumers receiving unauthorized or improper remotely created checks also have extended return timeframes facilitated by Regulation CC and the ECCHO Rules[9]. Each of these provisions rely upon the warranties of the financial institution that is sponsoring the payments into the various payment systems.

The nature of these consumer protection laws, rules and regulations, allow the consumer to be made whole in a timely manner by the consumer's financial institution who then relies upon the warranties provided by the sponsoring financial institution to be reimbursed[10]. The payment systems each have timeframes in which the payments can be returned to the consumer through the network, but generally these warranties extend beyond those timeframes and the consumer's financial institution can make a warranty claim outside of the payments network against the sponsoring financial institution. This warranty structure imposes the responsibility on the sponsoring financial institution and payment processor(s) to conduct proper due diligence on a merchant and to monitor the returns and chargebacks, along with consumer complaints, in order to effectively manage their exposure to credit, compliance and legal risks related to consumer

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[4] In some cases, payment processors will transmit this data directly to the payment system operator, but this can only be done through an agreement with the sponsoring financial institution and the payment system network. The sponsoring financial institution assumes all warranties for these payments either way.

[5] Payment system operators may be the same entity as the payment system network, or they may be different entities. For example, in the ACH Network, NACHA is the governing body for the ACH Network responsible for creating and enforcing the network rules. However, NACHA does not act as a payment system operator. This function is performed by the Federal Reserve Bank and The Clearing House, a private payment system operator.

[6] The payment system operator contracts directly with financial institutions, rather than payment processors. This is because the payment system operators facilitate settlement of the payments through the Federal Reserve Bank's National Settlement Service (NSS), which in turn facilitates transfer of funds between the sponsoring financial institution to the financial institution of the customer making or receiving the payment.

[7] Cal. Fin. Code § 2002.

[8] NACHA is a private membership organization for financial institutions clearing ACH payments and is the governing body responsible for network rulemaking published in the NACHA Operating Rules and Guidelines.

[9] ECCHO – Electronic Check Clearing House Organization is a private membership organization for financial institutions clearing electronic checks and is the governing body responsible for network rulemaking published in the ECCHO Rules.

[10] NACHA Rules § 2.4.1.1 Authorization Warranties and § 2.4.5 General Indemnity for Breach of Warranty

protection. The TPPPA CMS was designed to support financial institutions and payment processors to create compliance management programs to address these requirements.

## B. The Current Definitions of "Payor" and "Payee" Are Not Consistent with the Legislative History and Goals of the Agent-of-Payee Exemption.

The plain language of the agent-of-payee exemption appears to apply to only debit transactions and does not appear to be broad enough to include the wide range of ACH payments that can be either debits or credits. Additionally, payment processors provide their services to companies for a wide variety of goods and services that extend beyond payments that are in service of a debt owed for goods or services, as with traditional debit merchant processing.

For example, a vast number of electronic payments are "credit payments." Credit payments include, but are not limited to payroll, loan proceeds or drawdowns from a line of credit, expense reimbursements, distributions from an escrow account and things of that nature. When processing credit payments, the payor and payee are, in a sense, flipped, and the credit is not necessarily in satisfaction of a debt owed.

Another example is "elective debit" payments. Elective debit payments are not associated with the payment of a debt. Elective debit payments include, but are not limited to, transferring funds to investment accounts, making a donation, a campaign or other type of contribution, paying membership/association dues, signing up for services such as online shopping and things of that nature. Like credit payments, elective debit payments do not necessarily relate to the satisfaction of a debt owed.

The consumer/donor/employee does not bear the risk of loss with respect to credit payments and elective payments when these types of payments are initiated. The primary hallmark of the agent-of-payee exemption is that the consumer does not bear the risk of loss when a payment is effected.[11] Because, similarly, the consumer/donor/employee does not bear the risk of loss with respect to credit and elective debit payments, credit payments and elective debit payments should fall within the agent-of-payee exemption. But under California law, as currently written, these types of payments may not fall within the exemption because the person making the payment does not fall within the current definition of "payor" and the person receiving the payment does not fall within the current definition of a "payee." Under the current definition of "payee," a payee is a person "who is owed payment of money or other monetary value from the payor for the goods or services." A "payor" is person "who owes payment of money or monetary value to the payee for the goods or services." Simply put, these definitions assume that a the payor owes a debt to the payee. Because there is no preexisting debt obligation with respect to credit payments and elective debit payments, the participants in these types of transactions cannot take advantage of the "agent-of-payee" exemption. The TPPPA does not believe that the agent-of-payee exemption was intended to exclude credit payments and elective debit payments because, as stated above, exemption is intended to apply to payments where the consumer/donor/employee bears no risk of loss when the payment is effected.[12] Therefore, the TPPPA urges the Department to expand California's definitions of payor and payee to encompass credit payments and elective debit

[11] Cal. Fin. Code § 2010.

[12] Cal. Fin. Code § 2010; California Committee Report, 2013 California Assembly Bill No. 2209, California 2013-2014 Regular Session (April 25, 2014) (April 28, 2014) (August 13, 2014).

payments.[13]

## C. Response to Question Number 1 Concerning "Goods and Services"

### 1. What items do and do not fall within the term "goods or services"?

The TPPPA and its members view the term goods and services broadly to reflect the variety of products and services that are paid for by the means of electronic payments today including (1) typical debit payments that are in service of a debt, as with traditional merchant processing; (2) electronic credit payments (described above); and (3) elective debit payments (described above).

We believe that section 2105 of the California Commercial Code, which defines "goods" is sufficient:

> (1) "Goods" means 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 (Division 8) and things in action. "Goods" also includes the unborn young of animals and growing crops and other identified things attached to realty as described in the section on goods to be severed from realty (Section 2107).

The TPPPA proposes that the term "services" should include the provision of an act for another person or business as set forth in a written agreement or another form of mutual assent.

The TPPPA also believes that electronic payment processing itself is a service provided by a company to its customers, members, employees, partners, contributors, etc., as a convenience. This is based upon the requisite authorization/agreement that the person or entity making the payment obtains from the person or entity receiving the payment. Electronic payment processing provides benefit to consumers and businesses alike. Consumers have greater options to acquire goods or services, receive payroll, make donations or contributions, contribute to investments, pay taxes, purchase insurance, etc. The ability to choose to make electronic payments also serves the banked, underbanked and even non-banked consumer. This service is facilitated by payment processors and their financial institutions. Financial institutions, today, typically offer checking accounts without issuing checks to customers because it is beneficial to the financial institutions to avoid processing cash or check payments and it makes the entire payment system more efficient, effective and safe.

**(a) In particular, does the term "goods or services" encompass assets, rights, interests, or benefits of any kind or nature (e.g., residential housing, real estate, right of publicity, goodwill, intellectual property, insurance, etc.)?**

Yes, if consistent with the definitions set forth above in response to 1.

**(b) Alternatively, does the term "goods or services" refer only to the types of items and services one typically finds available on online marketplaces like Amazon and**

[13] The State of Texas, for example, expressly includes charitable donations and accounts for "credits" in its agent of the payee statute in an apparent recognition that the exemption should not only apply to preexisting debt obligations. 7 Texas Admin. Code § 33.4.

**Airbnb?**

No, for the reasons stated above.

**(c) Are payments in satisfaction of debts to the government (e.g., taxes, fees, fines) a payment for "goods or services?"**

Yes, for the reasons stated above in response to 1.

**(d) Please cite legal authorities (e.g., case law, legislative history, dictionaries) in support of the interpretation you advocate.**

California Commercial Code § 2105 defines goods. The online dictionary definition of service is "the action of helping or doing work for someone."

**(e) With respect to each of the alternative interpretations described in (a), (b) and (c) above, what is the economic impact that each interpretation would have on industry?**

Companies will be more efficient and, therefore, the economic impact will be a savings for people who initiate and receive payments. Consumers have greater options to acquire goods or services, receive payroll, make donations or contributions, contribute to investments, pay taxes, purchase insurance, etc. The ability to choose to make electronic payments also serves the banked, underbanked and even non-banked consumer.

Financial institutions, today, typically offer checking accounts without issuing checks to customers because it is beneficial to the financial institutions to avoid processing cash or check payments and it makes the entire payment system more efficient, effective and safe.

**D. Response to Question Numbers 2 and 3 Concerning "Receive"**

**2. What does it mean to "receive" goods?**
**3. What does it mean to "receive" services?**

"Receive" means actual physical receipt or the right to receive. It is important to note, however, that the NACHA Operating Rules utilize broader definitions that do not get bogged down with terms like "payor" or "payee." Rather, the NACHA Operating Rules focus on the impact to the account receiving either a debit or credit payment. The account holder (the recipient of the funds) is considered the "Receiver", and company initiating the payment is considered the "Originator" of the payment. (This terminology is also consistent with wire payments.) An Originator can be a merchant who is selling goods or services, but could also be a company paying employees, a church receiving donations or tithes, a non-profit organization receiving donations or membership dues, escrow companies facilitating contract terms, lenders providing loan proceeds or enabling draw down from a line of credit, a government receiving tax payments or paying public entitlements, and more.

**2(a) Does one "receive goods" only by being an end consumer – i.e., someone who intends to consume, experience, use, or gift those goods?**

No, please see comments in answer to questions 2 and 3.

**3(a) Does a commercial entity "receive services" when contractors perform contractual duties owed to the entity?**

Yes, please see comments in answer to questions 1, 2 and 3.

**2(b) Does one "receive goods" by physically receiving them but without consuming or experiencing them (e.g., by being a retailer that maintains goods in stock)?**

Yes, please see comments in answer to questions 2 and 3.

**3(b) Does a party "receive services" from a counterparty whenever that counterparty performs contractual duties owing to that party?**

Yes, please see comments in answer to questions 1, 2 and 3.

**2(c) Does one "receive goods" merely by receiving title to them, without having either physically received or consumed them (e.g., by being a merchant of record for goods that it acquired title to but never physically received)?**

Yes, please see comments in answer to question 2 and 3.

**2(d) and 3(c) Please cite legal authorities (e.g., case law, legislative history, dictionaries) in support of the interpretation you advocate.**

2019 NACHA Operating Rules and Guidelines §§ 8.81 (defines "Receiver"), 8.68 (defines "Originator); see *also* Legislative History of the agent-of-payee exemption at California Committee Report, 2013 California Assembly Bill No. 2209, California 2013-2014 Regular Session (April 25, 2014), (April 28, 2014) and (August 13, 2014).

**2(e) and 3(d) With respect to each of the alternative interpretations described in (a), (b) and (c) above, what is the economic impact that each interpretation would have on industry?**

Please see our response set forth in 1(e), above.

**3(e) Under Financial Code section 2011, the Commissioner may, by regulation, allow exemptions from money transmitter law in addition to what is currently provided in statute. Assuming that Financial Code section 2010, subdivision (l), is properly interpreted as applying only to a simple, three-party online marketplace transaction (as described on the bottom of page 1 and top of page 2) and that the Commissioner is open to exempting a broader range of commercial transactions based on agency law principles, describe the full range of commercial transactions to which you believe the agency-based exemption should apply. Please provide proposed exemption language reflecting your recommendation.**

**Expand the definitions of "payor" and "payee":** As stated above, the current definitions of payor and payee are too narrow because these definitions appear to be limited to debit transactions in which a debt is owed. These definitions do not encompass credit payments or elective debit payments where people make payments or donations without an existing debt.

Proposed language: *"'Payee' means one who is owed payment of money or other monetary value from the payor for the goods or services. A payee includes a person who receives a payment that is not in service of a debt or a non-profit organization, the intended recipient of a donation, or intended recipient of a credit." "'Payor' means one who owes payment of money or monetary value to the payee for the goods or services. A payor includes one who elects to make a payment that is not in service of a debt or makes a donation to a nonprofit organization or is issuing a credit."*

**Make it clear that the exemption can apply if a transaction involves more than one payment processor that acts as an "agent": "**Nested payment processors", sometimes referred to as "ISOs" (Independent Sales Organizations) also act as agents of the payee in a payments transaction. Like the companies described above that utilize payment processors for electronic payments, nested payment processors are usually small businesses. They utilize the primary payment processors as a gateway to the payment systems for many of the same reasons that a company processing its own payments would. The primary payment processor provides the credit and technology requirements to process through a financial institution. This practice is particularly prevalent in payroll processing where smaller payroll companies (often a CPA) utilizes larger payment processor to process payroll transactions. This is also common in typical merchant processing as well, where a smaller payment processor utilizes that primary payment processor as a gateway, leveraging the technology and banking relationship of its larger payment processor partners. Considering that the flow of authorizations moves with the initial payment instruction that goes to the nested payment processor, then the primary payment processor, the TPPPA and its members believe that both sets of payment processors should be included within the "agent" definition. Otherwise, the small payment processor (and its customers) may be denied the opportunity to process electronic payments, or the primary payment processors would bear the cost and consequences attributed to multi-state licensure, without the adding of additional risk. Proposed language: We suggest that the Commissioner keep the current definition of agent and add the following: "*There can be more than one 'agent-of-payee' in a single payment transaction."*

**Adopt the payment processor exemption under federal law, and expand it to include credit payments and elective debit payments:** Under federal law, certain payment processors are not required to register with FinCEN as a Money Services Business (MSB) if they meet all of the following: "(1) The entity providing the [payment processing] service must facilitate the purchase of goods or services, or the payment of bills for goods or services (other than money transmission itself); (2) The entity must operate through clearance and settlement systems that admit only BSA-regulated financial institutions; (3) The entity must provide the service pursuant to a formal agreement; and (4) The entity's agreement must be at a minimum with the seller or creditor that provided the goods or services and receives the funds."[14] We urge the State of California to consider adopting a similar law.

**Adopt an exemption similar to federal law for persons who incidentally engage in money transmission only to the extent reasonable and necessary to accomplish a primary business objective unrelated to the money transmission business:** Under federal law, a money transmitter is a person who engages in the business of money transmission as a distinct product or service, not a person who accepts and transmits funds "only integral to the sale of goods or the provision of services, other than money transmission services."[15] Based upon the legislative

[14] 31 C.F.R. § 1010.100(ff)(5)(ii)(B).

[15] 31 C.F.R. § 1010.100(ff)(5)(ii)(F).

history of the agent-of-payee exemption in California, it is clear that California similarly intends to exclude that same class of persons.[16]

For example, 0n April 29, 2014, the Financial Crimes Enforcement Network ("FinCEN") determined that a company that provided escrow services was not a money transmitter although the company received funds for transmission and transmitted funds.[17] FinCEN stated the following:

> "[T]he Company's money transmission activities are only necessary and integral to its provision of escrow services. In order to provide assurances to both buyer and seller that the buyer has enough resources to pay for the goods and services, on the one hand, and that those resources will not be released until the transaction is completed according to the purchase agreement, on the other, the Company needs to take possession of the funds and hold them in escrow until the pre-established conditions for the funds to be paid to the seller or returned to the buyer are met, then release those funds appropriately. The acceptance and transmission of funds do not constitute a separate and discrete service provided in addition to the underlying service of transaction management. They are a necessary and integral part of the service itself. Therefore, the Company would not be a money transmitter as that term is defined in our regulations."

Like California, when FinCEN enacted rules relating to money services businesses, it explained that the purpose of the predecessor to this definitional limitation[18] was to avoid an "unnecessary burden and the extension of the [BSA] to businesses whose money transmission activities... are ancillary to the completion of other transactions."[19] To require licensure under California law for these same activities could likewise impose an unnecessary burden on a wide variety of businesses that were not the intended target of California law. For that reason, the Commissioner should also exempt persons who accepts and transmits funds when such transmission is only incidental, yet integral to the sale of goods or the provision of services, other than money transmission services.

## E. Distinguishing Marketplace and Wallets from Payment Processors

The TPPPA believes that it is also important to distinguish online marketplace platforms, such as Amazon, eBay and AirBNB, from a payment processor. Most marketplaces accept a

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[16] California Committee Report, 2013 California Assembly Bill No. 2209, California 2013-2014 Regular Session (April 25, 2014) (April 28, 2014) (August 13, 2014).

[17] *See* FIN-2014-R004, Application of Money Services Business Regulations to a Company that Offers Escrow Services to a Buyer and Seller in a Given Internet Sale of Goods or Services, Issue Date April 29, 2014.

[18] Prior to 2011, the provision said that "money transmission" generally does not include "the acceptance and transmission of funds as an integral part of the execution and settlement of a transaction other than the funds transmission itself (for example, in connection with a bona fide sale of securities or other property)." *See* former 31 C.F.R. § 103.11(uu)(5)(ii) (1999). FinCEN made amendments to its regulations in 2011 that were intended to "update[], streamline[], and clarif[y]" the Regulations "by incorporating and extending" past FinCEN interpretations of "which activities are covered by or excluded from the definition" of an MSB. 76 Fed. Reg. 43585, 43586-87 (July 21, 2011). See also California Committee Report, 2013 California Assembly Bill No. 2209, California 2013-2014 Regular Session (April 25, 2014) (April 28, 2014) (August 13, 2014).

[19] 64 Fed. Reg. 45438, 45443 (Aug. 20 1999).

variety of different payment types. In some cases, companies that are not affiliated with the marketplace process these payments. In other cases, such as with Amazon, the marketplace may own a separate company that acts as the primary payment processor, such as Amazon Payments. This arrangement had existed in the past when eBay acquired PayPal, which after 15 years was subsequently spun off. PayPal is still a payment option in the eBay marketplace, but Adyen replaced PayPal as the primary payment processor. Adyen also provides the core software that AirBNB uses. AirBNB merchants have the choice to use the payment products offered by Adyen or simply use it as a gateway to other payment processing providers.

It is also important to distinguish a "wallet" provider from the typical payment processor. Payment processors like Amazon Payments and PayPal also provide a wallet service where a customer can utilize various different payment devices that they own, such as a financial institution account for ACH payments, or credit cards, or a line of credit offered by the payment processor. These wallet companies allow customers to load their credit and debit cards into the wallet and may also allow customers to fund their wallet, generally through ACH. These loaded funds are held under the control of the wallet provider, where funds can be transfer amongst the marketplace merchants for payment of goods or services, and sometimes outside the marketplace. A wallet service acts in a similar fashion and has similar risks to a pre-paid account. The money transmission from both a money laundering and consumer protection standpoint is vastly different with a wallet provider than with a typical payment processor that is merely moving data through BSA-regulated financial institutions to facilitate payments and should be considered separately from a typical payment processor.

In summary, and as set forth above, the typical payment processor moves basic payment related data in the form of payment instructions and the financial institutions move the money through their participation in the Federal Reserve Bank's Net Settlement Service. This applies to ACH, Card and Check payment processing.

Please feel free to contact me with any questions. The TPPPA would welcome the opportunity to bring a delegation of its members to meet in person to discuss this matter further with the Department of Business Oversight.

Sincerely,

Marsha Jones, AAP, APRP, CAMS
President
Third-Party Payment Processors Association