

Client Alert

February 17, 2016

Are You a “Payment Processor”? Washington State Appears to Significantly Expand Scope of Its Money Transmission Act

By Sean Ruff and Adam J. Fleisher

One of the defining aspects of the payments revolution of the past few years—at least from a regulatory perspective—has been the question of whether any particular payments service is subject to regulation as money transmission. Almost all U.S. states regulate money transmitters under state-specific licensing regimes; the statutory definitions of money transmission are quite broad and typically cover any entity that “receives” and “transfers” money.

These laws were crafted to address what we would today call “traditional” money transmitters—i.e., major, well-known brands that sell money orders, stored value cards, and offer domestic and international wire transfers. Today, however, there are a number of new and innovative companies that are playing a somewhat different role: They play a part in facilitating the *receipt* of payments by merchants and other sellers of goods and services (such as utilities) as opposed to facilitating the transmission of funds *on behalf of a sender*. An entity providing this type of service may have a contractual relationship with the recipient pursuant to which the entity is appointed as an agent to receive funds on behalf of that recipient (i.e., the merchant). In recent years, state licensing authorities—and various participants in this market—have grappled with whether, and to what extent, this type of activity could be subject to state money transmitter licensing laws. Indeed, a number of states have recently concluded that, subject to certain conditions, state money transmission licensing laws do not apply to services provided as an agent of a merchant or other recipient of funds pursuant to a direct contractual agreement.¹

Late last year, Washington State’s Department of Financial Institutions (“DFI”) entered the fray with an interpretive statement (“Statement”) that took effect in January. This Statement is unique, however, in that it *requires* a “payment processor” to obtain a licensing waiver from DFI *prior to operating in the state*. The Statement is not explicit about what constitutes covered payment processing, but it does describe “payment processors” as entities that “receive payments from consumers, settle payment transactions with or without financial institutions, and transmit payments to merchants’ or creditors’ accounts.” Furthermore, payment processors “may also provide marketing, billing, or other merchant service functions.”

WASHINGTON STATE’S ANALYSIS OF PAYMENT PROCESSING

According to the Statement, “[p]ayment processing is money transmission” as defined in the Washington Uniform Money Services Act (“Act”). The Statement explains that payment processors “provide money transmission services between various types of consumer/debtor/payors and merchant/creditor/payees.” For example, “[b]ill

¹ See, e.g., California Assembly Bill 2209 (codified at Ca. Fin. Code § 2010(l)); Virginia administrative rules (10 VAC5-120-10); Illinois interpretive guidance (“Statement Regarding Third-Party Payment Processors and the Transmitters of Money Act”), available at <http://www.idfpr.com/DFI/CCD/pdfs/07292015StatementThirdPartyProcTOMA.pdf>.

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payment processors contract with creditors to facilitate the creditors' receipt of payments from consumer/debtors." The Statement suggests that "payment processing" comes within the broad definition of money transmission under the Act, which includes "receiving money or its equivalent value to transmit, deliver, or instruct to be delivered the money or its equivalent value to another location . . . by any means . . ." ² Furthermore, the type of activity described as "payment processing" in the Statement is discrete from the type of activity that fits within the narrow statutory payment processor exclusion under the Act. ³ That exclusion from the Act applies to entities that sit between otherwise excluded entities, such as banks, but not to entities that intermediate between customers and merchants.

As a preliminary matter, in light of DFI's determination that a "payment processor" is a money transmitter, companies should examine closely whether their activities could trigger coverage as a "payment processor" in the eyes of DFI. Even if a company is a payment processor, however, if it meets specific conditions, it "may be eligible for a waiver from the license provisions of the Act." DFI's basis for permitting the waiver appears to be grounded in the fact that a payment processor may do so as an agent of the merchant (or other payee). In these scenarios, the DFI reasons that the risk to the consumer is diminished because "when the payment processor receives the consumer's payment, the consumer's payment obligation to the merchant is extinguished, *as if the consumer paid the merchant directly*" (emphasis added).

THE WAIVER—SCOPE

The Statement reiterates that the waiver is "limited to the licensing requirements" of the state's money transmission act, which raises preliminary questions about its scope. DFI apparently "retains its jurisdiction over the money transmission activities of the company even with the license waiver in place." (Note that, according to the statement, a "payment processor" is conducting money transmission.) The Statement specifies that companies under the waiver are "subject to entry and examination" to verify waiver eligibility and that DFI may "conduct examinations or investigations as permitted by the Act." The Statement does not, however, elaborate about what *obligations* DFI believes that a payment processor under a waiver would have under the Act.

We also note that the waiver applies to *existing* licensed money transmitters that provide services eligible for the waiver (i.e., "payment processing"). If a licensee obtains a waiver, the eligible activity no longer needs to be reported (this distinction matters for licensees because Washington imposes a yearly assessment based on transaction volume).

THE WAIVER—CRITERIA AND ELIGIBILITY

To be eligible for the waiver, the entity must:

- 1) Facilitate payments for goods or services (other than money transmission) or bill payments by receiving money from a consumer/debtor/payor and delivering it to a merchant/creditor/payee;
- 2) Operate through a settlement system that admits only BSA-regulated financial institutions;
- 3) Operate pursuant to a formal agreement with the merchant/creditor/payee; and

² See Rev. Code Wash. 19.230.010(18).

³ See *Id.* at 19.230.020(9).

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- 4) That agreement must create an agency relationship in which payment from the consumer/debtor/payor to the company satisfies the consumer/debtor/payor's obligation to the merchant/creditor/payee.

These four criteria track closely the "payment processor" exemption from the Bank Secrecy Act definition of a money transmitter articulated by the Financial Crimes Enforcement Network ("FinCEN").⁴

The DFI Statement, however, adds an additional and unique element to its waiver criteria: A "payment processor holding value beyond the time period necessary to complete the purchase of a good or service is not eligible for the license waiver." Finally, "a payment processor of virtual currency transactions," as well as a payment processor for the marijuana industry (pursuant, presumably, to the state's legalized regime) is not eligible for the waiver, regardless of whether the other conditions are met.

WHAT NOW?

This Statement establishes DFI's position that a "payment processor" is a money transmitter that must seek a waiver to operate in the state of Washington without a money transmission license. Companies that provide services to facilitate transactions in Washington should therefore evaluate whether their business models might make them a "payment processor" and whether the licensing waiver would apply to their business models. Any such analyses should be approached deliberately, especially in light of DFI's warning that a payment processor "must" seek a waiver "before conducting activity in [Washington] state," and that a failure to do so "risk[s] an action by [DFI] for unlicensed activity."

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⁴ See, e.g., 31 CFR § 1010.100(ff)(5)(ii)(B); FIN-2013-R002, *Whether a Company that Offers a Payment Mechanism Based on Payable-Through Drafts to its Commercial Customers is a Money Transmitter* (Nov. 13, 2013).

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