Client Alert

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Are You a Money Transmitter in Michigan? In California?

By Sean Ruff and Adam Fleisher

The payments and money transmission regulatory landscape continues to evolve. A key new development is that Michigan has affirmed by legislation that "agent of a payee" transactions meeting certain criteria are not subject to regulation under the state's money transmission licensing law. However, the California Department of Business Oversight (the DBO), which regulates money transmission in California, continues to scrutinize the scope of what constitutes payee-agency activity exempt from money transmission licensing.

WHAT IS AN AGENT OF A PAYEE IN MICHIGAN?

On December 31, 2018, Michigan governor Rick Snyder signed S.B. 729 into law, effective 90 days from signature (i.e., April 1, 2019). S.B. 729 makes a number of changes to the Michigan Money Transmission Services Act, Mich. Comp. Laws §§ 487.1001 *et seq.* (the "Act"). One important change excludes from the applicability of the Act "an agent of a payee," provided certain conditions are met.

First, S.B. 729 defines an agent of a payee as a "person appointed by a payee to collect and process payments as the bona fide agent of the payee." Second, a covered "payee" under the Act is defined as the "provider of goods or services, not including money transmission services, that is owed payment of money or other monetary value from the person that is paying for the goods or services."[1] Third, a person acting as agent of a payee is exempt if the person can "demonstrate[e]" to the director of the Michigan Department of Insurance and Financial Services (the "Director") that "all of the following" criteria are met:

- There is a written agreement between the agent and the payee "directing the agent to collect and process payments on the payee's behalf";
- "The payee holds the agent out to the public as accepting payments on the payee's behalf"; and
- When the agent receives the payment it is "treated as received by the payee."[2]

These provisions are generally consistent with "agent of a payee" exemptions affirmed by other states. However, because S.B. 729 states that an entity is exempt if it "demonstrates to the Director" that it meets the aforementioned criteria, companies seeking to avail themselves of the payee agency exemption in Michigan may need to affirmatively reach out to confirm the exemption.

[1] Mich. Comp. Laws § 487.1003(e), as amended.

[2] *Id.* at § 487.1004(f).

S.B. 729 – OTHER CHANGES

S.B. 729 also makes changes to provisions in the Act relating to stored value, which is re-characterized as "prepaid access" and defined in a manner similar to—though not the same as—the federal Bank Secrecy Act (BSA).[3] Specifically, S.B. 729 defines "prepaid access" as "access to funds or the value of funds that have been paid in advance and can be retrieved or transferred at some point in the future through a device or vehicle [e.g., a card, code, electronic serial number, mobile identification number, etc.]."[4] In addition, prepaid access that meets the following definition of "closed loop" (again, similar to but not the same as the BSA) is not subject to regulation under the Act:

> [A]ccess to funds or the value of funds that is paid in advance, may be retrieved or transferred at some time in the future through a device or vehicle, and may be used only to acquire goods or services in transactions that involve 1 or more specific merchants or 1 or more specific locations.

Of particular significance is that covered—and therefore exempt—closed loop includes devices that can be used at "1 or more specific merchants or 1 or more specific locations." This aspect of the definition differs from the approach taken in other U.S. states, which tend to define closed loop prepaid access (or its statutory equivalent) as an instrument, device, etc., that is redeemable *by the issuer* of the device for goods or services. By contrast, S.B. 729 appears to indicate that any device redeemable at "specific merchants" or "specific locations" could come within the definition of "closed loop" in Michigan, regardless of whether such a merchant or set of merchants is also the *issuer* of the device.

Additionally, S.B. 729 does not provide for a simple exclusion for such closed loop prepaid access, as do other U.S. state money transmission licensing regimes. The definition of "money transmission services"—the regulated activity under the Act—includes among other things "selling or issuing . . . closed-loop prepaid access." S.B. 729 also amends the Act such that it does not apply to a person who "issues, sells, or distributes . . . closed-loop prepaid access . . . if the funds associated with that [prepaid access] do not exceed $2,000.00 maximum value on any day." This exclusion imports the BSA concept of a ceiling on the amount of funds that can be associated with a particular device or vehicle for it to be excluded from the BSA regulations. This type of dollar-limitation structure has not previously been used by state money transmission regimes to differentiate between regulated and unregulated money transmission activity.

Finally, S.B. 729 adds an exemption for an agent of a depository financial institution that is exempt under the Act, provided that certain specific criteria are met.

AGENT OF A PAYEE TRENDS, AND MORE CALIFORNIA DEVELOPMENTS

Almost all U.S. states regulate money transmitters under state-specific licensing regimes. Statutory definitions of money transmission are quite broad and typically cover any entity that receives money for transmission. Thus, one of the most important regulatory issues for non-bank payments service providers is the extent to which money transmission laws apply to transactions where the intermediary acts as an agent to facilitate the receipt of payments by merchants and other payees, such as public utilities (as opposed to acting on behalf of a sender to transmit the sender's funds to a beneficiary designated by the sender.) And, the applicability of state money transmission laws can dictate whether and to what extent payments services can be offered, and whether money transmission licenses may be required.

[3] *See* 31 C.F.R. 1010.100(ww).

[4] Mich. Comp. Laws § 487.1003(h).

In light of the salience of the issue, we have been closely tracking recent regulatory developments relating to exemptions for payee-agency transactions (see, for example, our previous client alerts on Hawaii and Connecticut, and Washington). Michigan now joins the growing list of states that 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, there have been some countervailing developments. (See our prior discussions of these issues in Vermont and California.) For example, the California DBO responded unfavorably to a request for an interpretive opinion regarding the scope of the state's payee agency exemption. In a letter dated October 4, 2018, the DBO rejected a payment processor's contention that it was exempt under California's statutory agent of a payee exemption, Cal. Fin. Code § 2010(*l*). The company asserted that it was exempt because it "receives funds from a consumer/payor and delivers the funds to a merchant/payee pursuant to a preexisting written contract," and because "as soon as a payment transaction is authorized by a card company, the merchant's right to receive payment from the consumer purchasing the goods or services is replaced by the merchant's right to receive payment from [the payment processor]."

The DBO concluded that this activity was *not* exempt under Cal. Fin. Code § 2010(*l*). First, the DBO found that the written agreement governing the processing services did not include an express appointment of the processer as agent of the merchant. Second, the DBO found that the agreement did not expressly indicate that the authorization of the payment card transaction from the processor's financial institution to the processor satisfied the consumer's obligation to the merchant. Thus the DBO concluded that the elements of the exemption set forth at Cal. Fin. Code § 2010(*l*) were not met.

In light of these developments, businesses that rely on payee-agency exemptions should closely evaluate the structure of their arrangements—including the underlying contractual agreements—to assess whether they come within specific state exemptions and whether any affirmative steps need to be taken to confirm compliance with specific regulators.

Contact:

Sean Ruff
(202) 887-1530
sruff@mofo.com

Adam Fleisher
(202) 887-8781
afleisher@mofo.com

Client Alert

Financial Services Team

California		New York	
Alexis A. Amezcua	(415) 268-6557	Robert J. Baehr	(212) 336-4339
Elizabeth Balassone	(415) 268-7585	James M. Bergin	(212) 468-8033
Roland E. Brandel	(415) 268-7093	Meghan E. Dwyer	(212) 336-4067
Sarah N. Davis	(415) 268-7478	David J. Fioccola	(212) 336-4069
Henry M. Fields	(213) 892-5275	Marc-Alain Galeazzi	(212) 336-4153
Joseph Gabai	(213) 892-5284	Adam J. Hunt	(212) 336-4341
Angela E. Kleine	(415) 268-6214	Jessica Kaufman	(212) 336-4257
Jim McCabe	(415) 268-7011	Mark P. Ladner	(212) 468-8035
James R. McGuire	(415) 268-7013	Jiang Liu	(212) 468-8008
Mark David McPherson	(212) 468-8263	Barbara R. Mendelson	(212) 468-8118
Ben Patterson	(415) 268-6818	Michael B. Miller	(212) 468-8009
Sylvia Rivera	(213) 892-5734	Jeffrey K. Rosenberg	(212) 336-4130
William L. Stern	(415) 268-7637	Mark R. Sobin	(212) 336-4222
Nancy R. Thomas	(213) 892-5561	Joan P. Warrington	(212) 506-7307
Lauren Lynn Wroblewski	(415) 268-6458		

Washington, D.C.			
Marcie Brimer	(202) 887-6932	Steven M. Kaufmann	(202) 887-8794
Rick Fischer	(202) 887-1566	Bradley S. Lui	(202) 887-8766
Adam J. Fleisher	(202) 887-8781	Jeremy R. Mandell	(202) 887-1505
Natalie A. Fleming Nolen	(202) 887-1551	Elyse S. Moyer	(202) 778-1616
Calvin D. Funk	(202) 887-6930	Obrea O. Poindexter	(202) 887-8741
Susan I. Gault-Brown	(202) 887-1597	Sean Ruff	(202) 887-1530
Julian E. Hammar	(202) 887-1679	Trevor R. Salter	(202) 887-1527
Oliver I. Ireland	(202) 778-1614	Nathan D. Taylor	(202) 778-1644
Crystal N. Kaldjob	(202) 887-1687	Jennifer S. Talbert	(202) 887-1563

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