



Sustainable Economies Law Center

Legal education, research, advice and advocacy for just and resilient economies
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California Department of Business Oversight
Attn: Karen Fong - Legal Division
1515 K Street, Suite 200
Sacramento, CA 95814-4052
VIA EMAIL: regulations@dbo.ca.gov

Re: Notice of Proposed Rulemaking PRO 03/14

Dear Ms. Fong:

The Sustainable Economies Law Center (SELC) respectfully submits the following comments in response to the Notice of Rulemaking Action regarding the California Money Transmission Act (MTA). Last year, SELC provided legal advice to 224 Bay Area micro-enterprises, worker cooperatives, producer cooperatives, urban farms, cottage food enterprises, barter networks, community currencies, lending circles, and other unique enterprises and organizations. Most of our clients are organizations formed by people who are low income, unemployed, or underemployed.

We are concerned about the implementation of the MTA because many of our clients and constituents might be engaging in activities that meet the definition of money transmission, and we cannot think of a single client or constituent that could actually afford to comply with the MTA. Compliance with existing and proposed MTA regulations is prohibitively expensive for such entities, and this undermines the viability of many organizations and enterprises that are important to the economic health of communities in California.

Summary of Recommendations

We believe that the wellbeing of small businesses, community organizations, and the California economy require that the Department amend the regulations to do the following, which we describe in depth below:

- A) Revise or issue a new Notice of Rulemaking Action to include analyses of the impacts on small businesses and the economy,**
- B) Clarify the definition of “money transmitter” to make clear what activities are not included,**
- C) Create exemptions from all or parts of the law for certain small businesses and organizations,**

D) Specify a time period in which the Commissioner must respond to a letter requesting an order of exemption,

E) Reduce application requirements for certain small-volume and medium-volume money transmitters.

A) Assessing Impact on Small Business and the Economy

We believe the Department made a wholly inadequate determination by stating in the Notice that “the proposed regulatory action will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.” We believe this question merits much deeper inquiry and research into the wide variety of businesses that currently engage in money transmission. Money transmitters vary in their size and scope of activities, ranging from large-scale (MoneyGram, Western Union, and American Express) all the way down to grassroots organizations that facilitate mutual aid among members.

Because of this wide variation in the form and function of money transmitters, we believe the Notice should be revised to include “[a] description of reasonable alternatives to the regulation that would lessen any adverse impact on small business and the agency’s reasons for rejecting those alternatives¹.” In addition, as required by Government Code Section 11346.5(a)(7), the Department should revise the Notice of Rulemaking Action to include:

- “(A) Identification of the types of businesses that would be affected.
- (B) A description of the projected reporting, recordkeeping, and other compliance requirements that would result from the proposed action.
- (C) The following statement: “The (name of agency) has made an initial determination that the (adoption/amendment/repeal) of this regulation may have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states. The (name of agency) (has/has not) considered proposed alternatives that would lessen any adverse economic impact on business and invites you to submit proposals. Submissions may include the following considerations:
 - (i) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to businesses.
 - (ii) Consolidation or simplification of compliance and reporting requirements for businesses.

¹ Government Code 11346.2(b)(4)(B)

(iii) The use of performance standards rather than prescriptive standards.

(iv) Exemption or partial exemption from the regulatory requirements for businesses.”

Furthermore, the Notice of Rulemaking Action should be amended to comply with Government Code Section 11346.5(a)(10), requiring the Department to include an analysis of the potential economic impact. The Notice currently states that:

- The proposed action will not create or eliminate jobs within California;
- The proposed action will not create new businesses or eliminate existing businesses within this state;
- The proposed action will not affect the expansion of businesses currently doing business within California; [...]

To the extent that innumerable existing small businesses in California will now need to either register as money transmitters or seek an explicit exemption from the Department, it is quite likely that many businesses will cease, or never undertake, operations as a result of the administrative burden of complying with the regulations. SELC, alone, has been contacted by dozens of existing or incubating small businesses that are concerned about their compliance with these proposed regulations, and their inability to afford compliance should their activities constitute “money transmission.”

Money transmission is important to the viability of many small businesses. In order to compete with much larger companies, small businesses can create economies of scale by forming organizations and platforms through which they can sell their products and services. The platforms for the distribution and exchange of these resources are vital to the creation of thriving local economies. Because of the broad definition of “money transmission,” many of these platforms engage in activities that come under the definition of “money transmission.” At the same time, we do not believe these organizations are of the type that the MTA was designed to regulate. The MTA exists to “protect the interests of persons in this state who use money transmission services.” In practice, the onerous compliance requirements of the MTA harm the interests of small-scale, community-based businesses whose purpose is to serve specific community needs. Regulating these types of entities does not serve the policy goal of these regulations.

Only very large and well-capitalized businesses could afford the MTA’s \$5,000 initial license application fee, the \$2,500 annual renewal fee, the requirement to have \$250,000 or \$500,000 bond or securities on deposit, and the requirement to maintain a minimum net worth of \$250,000. Without a larger number of clear exemptions, the MTA could effectively confine the business of money transmission to a small number of very large businesses, and it will leave little or no room for a diversity of platforms on which to build thriving local economies.

Here are two examples of hypothetical organizations that make a positive contribution to local economies, but which will not be able to afford to comply with the MTA. The size, structure, purpose, and activities of the organization are such that there is a low risk that the money transmission activities could result in substantial consumer loss, fraudulent behavior, or money laundering.

Cottage Food Cooperative (CFC): CFC is a California Consumer Cooperative Corporation with 30 members, and each member is an individual with a home-based food business. CFC provides marketing services to the 30 members by picking up the members' products at their homes and bringing the products to sell at farmers markets and festivals. CFC returns any unsold products to the members after the events. CFC also markets the products on the CFC website; when a customer orders a jar of Member A's homemade jam, CFC notifies Member A and Member A ships the jam to the customer. CFC receives payment from the customer and holds the money in a special account for Member A, delivering payment to Member A every two weeks. CFC takes steps to comply with all applicable law, but CFC does not have the resources to comply with the MTA.

Empowerment Lending Circle (ELC): ELC is a California Nonprofit Mutual Benefit Corporation. The 12 members of ELC are women who have come together to provide financial support to one another. Every month, the women gather and socialize, and each one brings a check for \$200. ELC deposits the funds in the ELC bank account. That month, the ELC members choose one member to receive a loan of \$2200 from the aggregated funds. The members also choose a charity to receive a gift of \$50. The remaining \$150 stays in the ELC account to build a reserve fund that the members can choose to pay someone in the event of an emergency. Each month, a different member receives the \$2200 loan, until every member has received the loan at least once during the year. ELC takes all necessary steps to comply with securities law and tax law, but has no ability to comply with the MTA.

Ideally, every community would be full of organizations like the ones described above. They facilitate the establishment of small business and the creation of jobs, and they help community members exchange and obtain necessary sustenance. The economic benefits that the above organizations and businesses provide to communities far outweigh the risks associated with the activities. As such, it would greatly harm California's economy to subject the above organizations to the costly and burdensome requirements of the MTA.

Therefore, we request that the Notice of Rulemaking Action be revised to include an analysis of the impact on California small businesses and the economy, taking

into account the wide variation among money transmitters, and establishing more appropriate compliance requirements that take into account this variation.

B) Clarify the Definition of “Money Transmitter”

The definition of money transmission in the Financial Code is so broad as to encompass even very small businesses that receive money for transmission, sell or issue stored value, or sell or issue payment instruments². If the Department does not intend to apply the MTA to small businesses, then we believe this must be made clear. Currently, there is a confusing statement in the Notice of Rulemaking Action to this effect:

“The proposed regulations will not affect small business **because money transmitters are not a small business** within the meaning of Government Code section 11342.610.”

We believe that this statement is incorrect, because, while the definition of “small business” excludes financial institutions, not all money transmitters are financial institutions. Many businesses transmit money or issue stored value in their regular course of business, and this activity may be incidental to a primary business purpose of selling or facilitating the sale of goods and services. This activity does not make such a business a “financial institution,” but it does make it a “money transmitter” under the current definitions.

If it is true that the Department intends that small businesses not be considered money transmitters, then it is imperative to clarify the regulations on this point. Thus, we request that the Department include in the regulations a more specific definition of “money transmission,” and/or a list of activities that do not constitute money transmission, along with additional exemptions to registration, which we describe in section C. Our recommendations for the clarification of the definition of “money transmission” are as follows:

- 1) **Exclude money transmitted in the sale of goods and services:** We recommend that the regulations be amended to clarify the definition of money transmission in a way that is closer to that found in the regulations implementing the Bank Secrecy Act, which excludes from the definition of money transmitter an entity that:
 - Acts 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 (31 CFR 1010.100(ff)(5)(ii)(B)), and

² Cal. Fin. Code Section 2003(o) provides that “‘Money transmission’ means any of the following: (1) Selling or issuing payment instruments. (2) Selling or issuing stored value. (3) Receiving money for transmission.”

- Accepts and transmits funds only integral to the sale of goods or the provision of services, other than money transmission services, by the person who is accepting and transmitting the funds. 31 CFR 1010.100(ff)(5)(ii)(F).

2) **Exclude barter networks:** We recommend that the regulations be amended to clarify that a barter exchange or barter network does not engage in money transmission if it operates an online platform or accounting system that simply keeps records of exchanges of goods and services among members/users of the platform, so long as members/users have no expectation that “trade credits” or “points” earned by transacting through the platform are redeemable for dollars.

C) Create Categorical Registration Exemptions

As the statute and regulations are currently written, there are likely thousands - or even tens of thousands of businesses - that will immediately need to register as money transmitters or apply to the Commission for a determination of exemption. As such, we believe that - to reduce the burden on the state, taxpayers, and small businesses - the regulations should include additional categorical exemptions.

We were pleased to see that the proposed regulations now describe a more detailed procedure whereby an organization may apply to the Commissioner for a determination of exemption. However, this process gives significant discretion to the Commissioner and does not give specifics about the types of enterprises that would likely be found to be exempt.

Thus, we strongly urge the DBO to create the following additional categories of exemption:

1. Social Welfare Organizations: We were glad to see that Section 80.3002 of the most recent draft of the regulations creates a registration exemption for nonprofits that are tax exempt under 501(c)(3). In the same spirit in which the Department has proposed to exempt 501(c)(3) tax exempt nonprofits from registration under the MTA, we believe it is important to also exempt social welfare organizations exempt from taxation under 501(c)(4) or California Revenue & Taxation Code Section 23701(f). Such organizations are legally required to operate primarily to further the common good and general welfare of the people of the community, such as by bringing about civic betterment and social improvements.

There are many examples of positive organizations that - for various reasons - are unable to obtain tax exemption under 501(c)(3), but which bring great benefit to our communities. Examples include farmers markets,

car sharing organizations, and other organizations that engage in monetary transactions for the purpose of bringing critical goods and services to our communities. Many of these organizations obtain tax exemption under 501(c)(4) and/or 23701(f). To ensure that such organizations can operate in California without undue burdens, we believe that they should be explicitly exempt from the requirement to register as money transmitters.

2. Entities with small annual volume of transactions: An entity should be exempt if the total value of money transmitted or the aggregate face amount of payment instruments and stored value issued or sold in California by the entity is no more than \$1,000,000 per year. Because of the small volume of transactions, such entities pose a small risk of causing substantial harm to consumers. Furthermore, as a result of their small size and annual income, such entities would be extremely unlikely to be able to afford registration as money transmitters.

3. Cooperatives and Mutual Benefit Nonprofits with a moderate annual volume of transactions: An entity should be exempt if the total value of money transmitted or the aggregate face amount of payment instruments and stored value issued or sold in California by the entity is no more than \$10,000,000 per year, and the entity is structured as a Nonprofit Mutual Benefit Corporation, California Consumer Cooperative Corporation, or any substantially similar entity with democratic governance by individuals and entities who transmit money through the entity. As a result of its legal structure, such an entity is legally required to be transparent, and the consumers who transmit money through the entity have greater power to protect their interests through various due process mechanisms imposed by the California Corporations Code. In addition, the moderate total volume of transactions greatly decreases the potential number of members of the entity, creates greater accountability among members, and reduces the scale of potential harm.

It's important to acknowledge that the likely income to an entity engaging in money transmission is quite low in comparison to the total volume of transactions. Many money transmitters earn money by taking a fee that represents a percentage of the money that is transmitted. Such fees generally range from a fraction of a percent to 10%. If a cooperative facilitates transactions among its members and charges a 3% fee, and if the total volume of transactions is \$5,000,000 in a year, then the cooperative would gross only \$150,000 that year. If that cooperative had to comply with the MTA, it likely could not afford to do so in addition to covering the many other expenses associated with running a business.

4. Entities that meet the definition of small business: We believe an entity should be exempt from registration if it meets the definition of small

business under Government Code Section 11342.610. A business of that size, by definition, must deal in a smaller volume of transactions, and therefore poses less risk of substantial consumer harm. Furthermore, such a business would find it so costly to comply with the MTA, that it might simply be unable to afford to do so.

D) Create a Timeframe in Which the Commissioner Must Reply to a Letter Requesting an Order of Exemption

Section 80.3002 describes a process whereby an enterprise or organization may apply for a determination by the Commission that the enterprise is exempt from the requirement to register. In order to allow businesses to continue their operations or get up and running quickly, we recommend that the regulations be amended to require that the Commissioner issue a determination within 30 days of receiving the letter requesting an order of exemption.

E) Reduce Application Requirements for Moderate Volume Applicants

The current proposed regulations describe a long list of documents and information that each applicant is required to provide to the Commissioner when applying for a license. The statute, itself, also provides a list of required information for applicants, but the list is less detailed than the proposed regulations and the statute gives the Commissioner discretion to waive any information on that list (Financial Code 2023(d)). We believe that some applicants would find the proposed requirements to be incredibly burdensome to comply with and would find that the preparation of the application could be an enormous amount of time and a large amount in legal and other professional fees. As described below, we believe that the Commissioner should waive certain application requirements for applicants engaging in a moderate volume of transactions.

We recommend that the regulations take into account the fact that entities engaging in a moderate volume of transactions pose relatively low risk to their users and to Californians, as compared to the large companies for which the MTA was designed. In addition, even moderate volume applicants would have difficulty compiling necessary paperwork and information to complete an application, given that the entity's gross income is likely to be a tiny percentage of the total volume of transactions it facilitates. Applicants who meet the following definitions (collectively referred to as "Moderate Volume Applicants") should be required to comply with fewer requirements than applicants engaging in a larger volume of transactions.

- 1. Entities with a moderate annual volume of transactions:** An entity should be exempt from some application and reporting requirements if the total value of money transmitted or the aggregate face amount of payment

instruments and stored value issued or sold in California by the entity is no more than \$20,000,000 per year.

2. Cooperatives and Mutual Benefit Nonprofits with a moderate annual volume of transactions: An entity should be exempt from some application and reporting requirements if the total value of money transmitted or the aggregate face amount of payment instruments and stored value issued or sold in California by the entity is no more than \$40,000,000 per year, and the entity is structured as a Nonprofit Mutual Benefit Corporation, California Consumer Cooperative Corporations, or any substantially similar entity with democratic governance by individuals and entities who transmit money through the entity.

Below we have made a list summarizing the information and documents required to be submitted with an application for a license. We request that Moderate Volume Applicants not be required to submit the information and documents **in bold text** unless the Commissioner finds suspect information in the application which merits further scrutiny and investigation into the financial well-being and ethical character of the applicant and its offices, directors, control persons, and subject persons.

The current proposed regulations require an applicant to submit the following information, which we have summarized for the sake of brevity:

1. A “facing page” in the form of Department Form 2110 (§ 80.4102)
2. Legal name and residential business address of the applicant and any fictitious or trade name used by the applicant in conducting its business. (§ 80.4104(a))
3. Date of the applicant’s incorporation or formation and the state or country of incorporation or formation. (§ 80.4104(b))
4. Summarize the history of the applicant. (§ 80.4104(c))
5. Describe the business of the applicant. (§ 80.4104(d))
6. Explain the reason(s) why the applicant wishes to engage in the transmission business. (§ 80.4104(e))
7. **Name, business address, and telephone number of at least two banking references. (§ 80.4104(f))**
8. **Name, business address, and telephone number of at least two business references. (§ 80.4104(f))**
9. List of other states in which the applicant is licensed to engage in money transmission and any license revocations, suspensions, or other disciplinary action taken against the applicant in another state. (§ 80.4104(g))

- 10. Recent independent review regarding compliance with federal anti-money laundering laws, including the U.S. Patriot Act and the Bank Secrecy Act, and the applicant's response to such review. (§ 80.4104(h))**
11. Information about directors, officers and controlling persons of the applicant, if applicable:
- a. Suspension or revocation of any license or other authorization or qualification to engage in any profession, occupation, vocation, or other business activity. (§ 80.4104(i)(1))
 - b. Information concerning any bankruptcy or receivership proceedings or an application has been made for reorganization, arrangement, or other relief under any bankruptcy, reorganization, insolvency, or moratorium law;
 - c. An application has been made by a third party for the appointment of a receiver, fiscal agent, or similar officer or for other relief of the kind described in subdivision (h)(2);
 - d. Suffered judgment in any civil action based upon conduct involving fraud or dishonesty; or,
 - e. Been convicted of, pleaded nolo contendere to, or is being charged with, any crime relating to the business of transmitting money, the business of issuing or selling payment
12. Information about directors, officers, control persons, or 10% equity security owners ((80.4105(b-j)):
- a. Name.
 - b. Social security number.
 - c. Title of each position held with the applicant.
 - d. **Confidential Resume and a current Personal Financial Statement.**
 - e. The legal name, any fictitious or trade name, all business and residential addresses, employment, and the education background.
 - f. **The name, address, and telephone number of at least two banking and two business or personal references.**
 - g. **Written authorizations signed by, and for, each individual authorizing the Commissioner to obtain information regarding their deposit and credit relationships with financial institutions, and general business background from business and personal references.**
 - h. **A list of any criminal convictions and material litigation in the 10-year period next preceding the submission of the application.**
 - i. Description of business experience during the last five years, including his principal occupations, and name/address of entities they worked for.
 - j. Description of circumstances if any court or governmental agency has suspended or revoked any license to engage in money transmission,

the business of banking, the securities business, or any, or removed a person from such business, imposed a monetary penalty in connection with such business, revoked a license to engage in any profession or occupation, etc.

- k. Description of circumstances if the subject person or any associated organization of the subject person has applied for an adjudication of bankruptcy, reorganization, arrangement, or other relief under any bankruptcy, reorganization, insolvency, or moratorium law.
 - l. Description of the circumstances if any person has applied against the subject person/any associated organization of the subject person/any business or property of the subject person/any associated organization of the subject person for the appointment of a receiver, fiscal agent, or similar officer and such application is pending or such relief has been granted.
 - m. Description of the circumstances if any court has entered judgment against the subject person or any associated organization of the subject person in any civil action based upon conduct involving fraud or dishonesty.
 - n. Description of the circumstances if the subject person or any associated organization of the subject person has pleaded nolo contendere to, been convicted of, or been charged as a defendant in a pending criminal proceeding with, any crime relating to any business of the kind referred to in Subparagraph (A), Paragraph (2) of this Subdivision (d) or any crime involving fraud or dishonesty.
 - o. **Information about prior indebtedness to the applicant by its associates, directors, and officers.**
- 13. Fingerprints and background checks for officers, directors, and other control persons § 80.4105.10.**
- 14. Investigative background report prepared by a search firm on control person who are not residents of the United States. § 80.4105.11.**
- 15. Certificate of Good Standing of the entity issued by the CA Secretary of State (§ 80.4106(a))**
16. Description of the legal structure of the applicant (§ 80.4106(b))
17. Copy of the Articles of Incorporation or Articles of Organization (§ 80.4106(c))
18. Operating agreement, if an LLC (§ 80.4106(c))
19. Description and amount of securities issued by applicant § 80.4107
20. Name, address, title, and amount of equity for any 10% equity security owner 80.4108
21. Information about parents and subsidiaries of the applicant § 80.4109.
22. Balance sheet § 80.4111(a)(1)(A)

23. Documentation to support the value of any asset totaling more than 10% of total assets. § 80.4111(a)(1)(A)

24. Statement of income for three preceding years § 80.4111(a)(1)(C)
25. Statement of cash flows for three preceding years § 80.4111(a)(1)(C)
26. Statement of shareholders' equity for three preceding years § 80.4111(a)(1)(C)
27. Financial statements for subsidiaries § 80.4111(a)(2)
28. Financial statements for parents § 80.4111(b)
29. Information about money transmission transactions outside of California § 80.4111(c)
30. Copy of last two annual reports to shareholders for applicant and any parent § 80.4111(d)(1) and § 80.4111(e)
31. Annual reports filed with the Securities and Exchange Commission, if applicable, for applicant and any parent. § 80.4111(c)(2) and § 80.4111(e)
32. Financial statements and unconsolidated financial statements for most recent fiscal year or two years, if available - certified as correct by CFO of applicant. **(Note that the language here could be improved to clarify that none of the financial statements must be audited)** § 80.4111(f)
33. Information about any material legal proceedings to which applicant is a party § 80.4113.
34. Business plan § 80.4115.
35. Description of the business and operations, including policies for processing complaints, monitoring branch offices, procedures for issuing payments and stored value, and recordkeeping 80.4118
- 36. Information Regarding Office of Foreign Assets Control ("OFAC") Compliance § 80.4118.10.**
- 37. Information Regarding Bank Secrecy Act ("BSA") Compliance § 80.4118.11**
38. Sample forms of receipts and payment instruments to be used by applicant § 80.4119.
39. Information about use of a clearing bank. § 80.4120.
40. Pro forma financials for first half-year, year, second year, and third year of operation, including statement of money transmission business conducted, statement of money transmission liabilities § 80.4121.
41. Explanation of how the financial status of the applicant is not impaired by having total money transmission liabilities that exceed equity § 80.4123.
42. Evidence that the Board has authorized the application and the release of any necessary information by other agencies § 80.4124

In sum, the proposed rulemaking to implement the Money Transmission Act represents a significant action to regulate a dynamic and quickly evolving California economy. This is a vital opportunity to ensure that California's small business and social entrepreneurship communities, among the most dynamic in the world, are not unduly impacted by regulations intended to protect the people of California. As California's economy evolves to provide for more of its citizens through cooperatives, lending circles, peer-to-peer distribution platforms, and other innovative economic projects, we hope this rulemaking process will protect the interests of those creating more just and resilient local economies.

We thank you for your time and attention in considering these comments and proposed revisions. We would welcome the opportunity to meet with you and further discuss any comments or considerations. Feel free to contact me via email at Janelle@theselc.org or by phone at 510-649-9956.

Sincerely,

A handwritten signature in black ink, appearing to read "Janelle Orsi". The signature is fluid and cursive, with a distinct loop at the end.

Janelle Orsi,
Executive Director