



April 26, 2014

California Department of Business Oversight
Legal Division
Attn: Karen Fong (PRO 03/14)
1515 K Street, Suite 200
Sacramento, CA 95814-4052
VIA EMAIL: regulations@dbo.ca.gov

Re: Comments on Proposed Rulemaking under the California Money Transmission Act
(PRO 03/14)

Dear Ms. Fong:

The Sustainable Economies Law Center (SELC) respectfully submits the following comments on the proposed rulemaking for the California Money Transmission Act (MTA). 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 and this prevents the establishment of many projects and enterprises that are important to the economic health of communities in California.

Our specific recommendations are described below and summarized here:

- A. **Clarify the exemption process:** The regulations should be amended to specify a clear process by which a person may apply to the Commissioner for a decision that the person is exempt from regulation under the MTA.
- B. **Create defined categories of exemption:** The regulations should create additional categories of persons who are, by definition, exempt from the MTA.
- C. **Reduce application and compliance requirements for certain persons:** The regulations should create a category of person for whom application and compliance hurdles are much lower.

Below, we also recommend that the DBO work with legislators to amend the Money Transmission Act so that the fees and security requirements for licensees will reflect the size, nature, number of transactions, and resources of the entity engaging in money transmission.

Background and Concern

SELC provides education, research, advice, and advocacy to create a world where every community has a diversity and multiplicity of small-scale, community-owned, and cooperatively-owned enterprises that create sustainable sources of food, housing, energy, jobs, and other vital resources. 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.

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 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 and multiplicity of platforms on which to build thriving local economies.

Here are some examples of hypothetical organizations that make a positive contribution to local economies, but which cannot 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 laws, 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 member 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.

Our Town Barter Network (OTBN): OTBN is an online barter network operating in a small rural California town where unemployment rates hover around 20%. The OTBN software is owned by and administered by a two-member LLC. Individuals and businesses can join the network for free and receive an initial credit of 200 Trade Credits. There are 400 members offering their goods and services through OTBN. When Member A provides a service to Member B, OTBN reduces the Trade Credits in Member B's "account" and raises the Trade Credits in Member A's "account" by the equivalent amount. Members pay a small fee to the LLC for use of the platform. OTBN provides a platform through which town residents can meet important needs, even when dollars are scarce in the community. OTBN and its members comply with all necessary tax laws. However, if OTBN were to be considered to be engaging in money transmission, it would not have any resources 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.

Specific Recommendations

The Proposed Changes under the California Money Transmission Act offer a step in the right direction, because they provide greater detail about the situations in which the Commissioner may determine that "regulation of [...] persons and transactions is not necessary to the purpose of the Money Transmission Act." (§80.3002) However, the proposed regulations fail to specify a procedure by which a person can apply for such a determination. If a person does not fall into any categories that are specifically exempted from the Act, the person is left with a great deal of uncertainty about if or when it will receive a determination by the Commissioner that it is exempt. Furthermore, the proposed regulations fail to create any additional categories of

persons that would be exempt. We believe there are many objective criteria that can be used to determine that regulation of a person or transaction is not "in the public interest and that the regulation of such persons or transactions is not necessary for the purposes of" the Act. Thus, we recommend that the regulations be amended as follows:

A. Create a Clear Process for Applying for a Determination of Exemption

The regulations should specify the form and content of information that a person should provide to the Commissioner when seeking a determination that the person is exempt from regulation under the Act. We recommend that the application require a simple narrative that summarizes the purposes and activities, the legal and governance structure, and the anticipated volume and types of transactions administered by the entity. We recommend that the Commissioner issue a determination within 30 days of receiving the application for determination of exemption. We recommend that the fee for the review of such an application be no more than \$300.

B. Create Clear Categories of Exemption

Since even the above-described process of applying for an exemption would be time consuming to a business or organization, and since the process of issuing a determination is time consuming and costly to the Commissioner and to the State of California, we recommend that the following types of people and organizations be categorically exempt from regulation under the Act. We recommend that the exemption be self-executing or that such an entity be required only to file a simple notice with the Commissioner stating that it has been or will be engaging in money transmission, and specifying the category of exemption it falls fall under.

We request that the following people and organizations be categorically exempt from regulation under the Act:

1. **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.
2. **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 Corporations, or any substantially similar entity with democratic governance by individuals and entities who transmit money through the entity.
3. **Nonprofit Public Benefit Corporations:** An entity should be exempt if it is a Nonprofit Public Benefit Corporation that operates for charitable or social welfare purposes and which has received recognition of tax exemption under Internal Revenue Code Section 501(c)(3) or 501(c)(4).

4. **Barter Exchanges:** An entity should be exempt if it operates an online platform 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. We agree with the comments submitted to the DBO by the International Reciprocal Trade Association (IRTA) on April 25, 2014 and believe that barter exchanges described in that letter should not be regulated.

5. **Geographically Limited Entities:** An entity should be exempt if it transmits no more than \$10,000,000 in dollars or equivalent value per year, and it operates platforms for the exchange of goods or services, online or otherwise, that limit participation or membership to residents of or exchanges within a substantially limited geographic area within the state of California (such as limiting membership to residents of three counties).

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.

C. 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 statutory and proposed requirements to be incredibly burdensome to comply with and would find that the preparation of the application could take an enormous amount of time and expensive legal fees 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 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 that merits further scrutiny and investigation into the financial well-being and ethical character of the applicant and its officers, 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. Summary of the history of the applicant. (§ 80.4104(c))
5. Description of the business of the applicant. (§ 80.4104(d))
6. 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 (§ 80.4104(i)):

- a. Information concerning suspension or revocation of any license or other authorization or qualification to engage in any profession, occupation, vocation, or other business activity.
 - 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. Information about whether applicant 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. Information about whether applicant has 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 persons 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, 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)

D. Advocating for a Better Money Transmission Act

In addition to the recommendations we have made above, we also request that the DBO work to amend the Money Transmission Act in 2015, since certain parts of the statute currently leave no room for discretion on the part of the Commissioner and leave no room to take into account the size, nature, and resources of the entity engaging in money transmission. For example, the \$5,000 initial license application fee, the \$2,500 annual renewal fee, the requirement to have a \$250,000 or \$500,000 bond or securities on deposit, and the requirement to maintain a minimum net worth of \$250,000 were designed for very large companies. We believe all of these dollar amounts should be amended to be a percentage of total volume of transactions that the applicant engages in. A company that engages in no more than \$100,000 in transactions in a given year should clearly not have to secure the transactions with \$250,000 on deposit. In addition, we believe that the application fee should be substantially lower for smaller entities engaging in a low or moderate volume of transactions.

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,



Janelle Orsi,
Attorney and Executive Director

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