Payment Processing Without Money Transmitter Licenses

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WePay, Inc., provides integrated payments – payments delivered as part of online platforms, such as marketplaces, crowdfunding websites, and business tool providers. Online platforms bring together producers and consumers.[1] Consumers want to pay producers. By providing a means to make those payments, platforms provide a useful service to their users, increase their users' loyalty, and earn revenue. So-called "application wallets" – credit card numbers or other payment credentials stored by a platform in a user's account - are a promising new channel to distribute payment services in a crowded and competitive marketplace.[2]

Some platforms, like AirBnB, choose to develop their own payment service internally. This requires a substantial investment in software development, compliance programs, and relationships with vendors, including the Card Networks (Visa, MasterCard, etc.), acquiring banks, and processors. Payment service providers have significant security obligations under the Payment Card Industry – Data Security Standards (PCI-DSS), tax reporting obligations under provisions such as IRC 6050W, and anti-money laundering (AML) and counter-terrorist financing (CTF) obligations under the BSA and USA Patriot Act. Online payments are targets for criminals, so providers must invest to defend against unauthorized credit card charges, account takeover, and other types of fraud.

Some platforms, like eBay, use a third-party payment service, like PayPal, to provide payment services to their users. This approach frees the platform from the burdens of developing and operating its own payment service. The platform has less control of the user experience, however. Users typically are presented with the payment service's brand, in addition to the platform's own brand. Users may be redirected from the platform to the payment service's website, or need separate credentials to log into a payment service account.

WePay provides an application programming interface (API) that platforms can integrate in order to provide payment services to their users.[3] The leading personal donations website, GoFundMe, uses the WePay service, as does the online invoicing website, FreshBooks. Using the WePay service, each payee becomes an individual "submerchant" under the Card Network Rules. Funds settle directly to the payees, not to the platform. The platform is insulated from financial loss due to chargebacks, and WePay screens transactions for fraud. Because the platform is not in the flow of funds, the platform is not at risk of being subject to money transmitter licensing requirements. By contrast, a platform that uses its own merchant acquiring account to process payments for its users takes on risk and compliance responsibilities. Processing a transaction to which the platform is not a party, such as a transaction between two users of the platform, is also prohibited "laundering" under the Card Network Rules, unless the platform registers as a Payment Services Provider or Payment Facilitator.

WePay differentiates from other payment service providers by supporting tight integration of its payment services with the platform. WePay permits the platform to put its own brand first. Users do not have to leave the platform's website to set up a submerchant account or make a payment. WePay even supports single sign-on, so that a submerchant can access the submerchant's payment information by logging into a platform account, without having to log into a separate payment service account. WePay's "two thumbs up" value proposition gives platforms control of the user experience, while protecting them from compliance burdens and payment risk.

Transactions on platforms can look like money transmission because there is a third party (the platform or payment services provider) in addition to the two parties who are directly involved in a transaction. PayPal, AirBnB, and others are registered as "money services businesses" by the federal government[4] and as "money transmitters" by state governments, such as California.[5] WePay is not. How can this be?

<u>Background</u>

Federal law defines "money transmission services" as "the acceptance of currency, funds, or other value that substitutes for currency from one person and the transmission of currency, funds, or other value that substitutes for currency to another location or person by any means." 31 CFR Section 1010.100(ff)(5)(i)(A). State laws vary, but many are based on Uniform Money Services Act, which contains the following definition in Section 102(14): "'Money transmission' means selling or issuing payment instruments, stored value, or receiving money or monetary value for transmission."

The paradigmatic money transmitter is Western Union. Western Union collects cash from consumers in face-to-face transactions and sends it to their designated recipients, often abroad. Payers are at risk that the money never is delivered, either because of malfeasance by the money transmitter, or because the funds are subject to claims by creditors of the money transmitter.

Money transmitter licensing laws mitigate these risks by requiring money transmitters to have minimum net worth, to purchase bonds insuring customer funds, to invest customer funds in approved instruments, and to deliver funds to recipients promptly, among other requirements. Regulators enforce these requirements through periodic onsite audits of licensed money transmitters, supported by substantial licensing fees.

Are platforms, or the payment service providers that support them, money transmitters? It depends on the flow of funds.

<u>WePay's Flow of Funds</u>

WePay provides data processing services, not money transmission services. The key difference is that WePay never takes possession of customer funds. Because WePay never receives money, WePay never transmits money. Therefore, WePay's activities do not constitute "money transmission."[6] It is not necessary to reach the question of whether WePay falls with an exception, because the definition of "money transmission" does not apply.

Indeed, it would be challenging to apply money transmitter licensing requirements to WePay. WePay does not hold customer funds, so WePay cannot purchase bonding insurance for them or invest them in suitable instruments. There is no WePay bank account holding customer funds that regulators can audit.

WePay developed its flow of funds in cooperation with Fifth Third Bank and Vantiv, a credit card processing gateway. To support WePay's flow of funds, Vantiv and Fifth Third Bank (together, the "Bank") provide an account in the name of the Bank to process transactions for WePay submerchants. On behalf of submerchants, WePay collects transaction data and submits it to the Bank. The transaction data includes the submerchant identification, so the Bank can identify the submerchant associated with a particular payment. The Bank submits the data to the Card Networks and the Automated Clearinghouse (ACH), as appropriate, which settle funds to the Bank. The Bank is responsible for settling with submerchants via the settlement account. Customer funds do not appear on WePay's balance sheet. WePay's Terms of Service identify the Bank as the party that is ultimately responsible for payments to submerchants.

Note that there is nothing in this description that is specific to businesses rather than to consumers. In general, the Card Networks support payments to businesses for goods and services. It can be challenging, however, to distinguish sole proprietors and other "micro-businesses" from individuals receiving payments for personal, family, or household purposes. The Card Networks have interpreted payments for "goods and services" broadly, so as to include donations to charities. It is a small step from supporting donations to registered charities, to supporting payments to informal groups and needy individuals, to supporting personal remittances. WePay has been in the vanguard of this progression. WePay is expanding the online financial franchise, both to platforms that want to provide payment services, and to persons who want to accept card payments for non-traditional purposes. WePay's vision is a level playing field on which any person who can pay with a credit card, can also accept payments by credit card. In WePay's view, the customer benefits of such symmetry significantly outweigh the risks.

WePay depends on the Bank, the Card Networks, and the regulators, to support its progress to this goal.

<u>Advantages and Disadvantages</u>

It has been a great benefit to WePay not to be subject to money transmitter licensing requirements. Applying for and maintaining money transmitter licenses is a multi-million dollar effort that exceeds the resources of most early stage businesses.

WePay has not, however, been free from oversight. First, the Bank is keenly interested in the integrity of WePay's operations. WePay provides regular reporting regarding submerchant transactions and balances as well as chargebacks, refunds, and other indicators of processing quality. The Bank in turn is subject to regulation and oversight by the Office of Comptroller of the Currency and other financial regulators.

Second, WePay is subject to the Card Network Rules, enforced by regular on-site audits and technical certification requirements. WePay is subject to the ACH Rules, enforced by monitoring and fines. And, numerous federal and state laws apply to WePay, addressing matters such as electronic signatures, online marketing, consumer protection, and data privacy.

Third, like any business, WePay has AML/CTF obligations. WePay regularly performs an internal AML/CTF risk assessment and follows up appropriately. WePay collects and validates "Know Your Customer" information from submerchants and screens all names against sanctions lists. WePay has a full-time Deputy Chief Compliance Officer, who works work with WePay's General Counsel and Risk Team. WePay files Suspicious Activity Reports (SARs) with FinCen on a voluntary basis. And, WePay has a robust internal AML/CTF training program, supported by regular third party reviews.

Fourth, WePay is PCI-DSS compliant at Level 1, based on its transaction volume. WePay's security obligations extend to verifying the security of some of its integrated platforms.

In sum, even though WePay does not hold state money transmitter licenses, WePay conducts its business so that it is licensable. Any other policy would be reckless in light of the complexity and pace of change in this area of law, and the severe consequences of a determination that a license is required. At last count, 47 states and the District of Columbia had money transmitter licensing laws, all with slightly different language and subject to varying interpretations.[7]

There are disadvantages to operating without money transmitter licenses. Above all, there are limits on product functionality. For example, the Bank disburses funds only to submerchants, not to other third parties. So, if a campaign organizer on SchoolAuction.net wants to pay out funds raised to multiple teachers, the campaign organizer will have to do so outside of the WePay service. Additionally, the Bank disburses funds to submerchants promptly after the funds settle to the Bank. Neither WePay nor the platform has the latitude to hold funds, for example, until the submerchant performs a contract or some other contingency is satisfied. The Card Network Rules provide some latitude to delay payments while investigating fraud, or to hold a reserve to mitigate chargeback risk. But, the Bank will not delay disbursements to submerchants in order to provide functionality similar to, say, online escrow.

Conclusion

By using the WePay payment service, a platform can customize its user experience while enjoying protection from compliance burdens and payment risk. WePay's innovative flow of funds enables WePay to provide payment services without money transmitter licenses. This approach results in significant cost savings for WePay. WePay remains subject to rules and oversight by multiple public and private organizations, however. And, the WePay payment service is limited to prompt settlement by the Bank to submerchants. WePay's business model illustrates how a company can leverage its relationship with a regulated financial institution to provide payment services without money transmitter licenses.

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[1] Van Alstyne, Parker and Choudary, "Pipelines, Platforms, and the New Rules of Strategy," Harvard Business Review, April 2016, https://hbr.org/2016/04/pipelines-platforms-and-the-new-rules-of-strategy.

[2] Alex Rampell, "Why your wallet is becoming the next platform," Techcrunch, April 24, 2016, http://techcrunch.com/2016/04/24/why-your-wallet-is-becoming-the-next-platform/.

[3] WePay currently provides services to submerchants located in the United States, Canada, and the United Kingdom. The flow of funds is different in each country. This article describes the flow of funds for United States submerchants only.

[4] FinCen maintains a list of money services businesses at: https://www.fincen.gov/financial_institutions/msb/msbstateselector.html

[5] The California Department of Business Oversight maintains a list of licensed money transmitters at: http://www.dbo.ca.gov/Licensees/money_transmitters/money_transmitters_directory.asp

[6] The California Department of Business Oversight confirmed WePay's interpretation by opinion letter dated May 20, 2014.

[7] The State of Washington Department of Financial Institutions recently published Interpretive Statement 2015-1 (revised May 2, 2016), stating that certain payment processors may be eligible to apply for a waiver from money transmitter licensing requirements. http://www.dfi.wa.gov/sites/default/files/opinions/is-2015-01.pdf The Statement asserts that an eligible company "may receive money or its equivalent value . . . or the company may constructively control the flow of money without actual receipt of the money." The apparent expansion of the scope of the statute is a source of serious concern.