



November 1, 2019

Dear Conference of State Bank Supervisors,

S & W Payroll Services L.L.C., which does business as Netchex (hereinafter referred to as “Netchex”), submits this comment letter to the Conference of State Bank Supervisors (“CSBS”) in response to its request for comments on the draft model language for state money services businesses (“MSB”) laws. Netchex supports the CSBS’ efforts to streamline MSB regulation and appreciates the opportunity to provide comment on the significant progress that the CSBS has made together with the working group of state volunteers in developing the model language.

### ***Background on Netchex***

Netchex provides human resources and payroll processing services to employers across the United States, with a focus on small to medium businesses. The company was founded over a decade ago by two executives in the payroll industry who decided to take on the large and established players in the payroll industry and change the experience of payroll outsourcing. Netchex positions itself at the forefront of the industry to keep clients informed and compliant, enabling thousands of businesses to work better with less work internally by using a trusted external partner for payroll services.

### ***Comments***

One of the primary reasons Netchex feels compelled to comment is that the exemption for payroll services is still listed as “TBD” in the CSBS draft model state MSB law. Netchex has first-hand experience dealing with the complex money transmission regulatory environment that currently exists in the United States. Therefore, Netchex is uniquely positioned to provide comment on why payroll service companies should be explicitly exempted in the model law. The following additional comments address some of the various open issues in the major sections outlined in the draft model state MSB law.

### **Exemptions**

While not listed as an outstanding question, it appears there is uncertainty on whether or not payroll services will be exempt in the final model law. Various states, including three represented on the working group, have specifically exempted payroll processors from licensing as money transmitters due to the reduced risk of payroll service providers adversely impacting consumers and the valuable functions payroll service providers perform for businesses. We would encourage the representatives from California, Ohio and Washington to consider and perhaps articulate to the rest of the working group how exempting payroll service companies from money transmission laws has benefitted the industry and consumers in their respective states.

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States that have exempted payroll processors from money transmitter laws have largely done so on the basis that money transmission is an ancillary component of a payroll processor's overall business purpose and activities. Besides money transmission being an ancillary component of payroll processors' core business, there are additional important considerations for why payroll processors should be exempt under state MSB laws. Payroll services companies provide a critical service to small businesses in the United States. According to the United States Small Business Administration, small businesses represent over 99% of all employer firms and pay nearly 50% of total U.S. private payroll.<sup>1</sup> Approximately 50% of Netchex's client base is comprised of businesses with twenty (20) and under employees, and two-thirds of Netchex's client base is comprised of businesses with fifty (50) and fewer employees.

Small businesses outsource payroll processing because it is a non-core function that requires significant expertise. Outsourcing payroll reduces the risk of payroll not being processed correctly, helps companies focus on their core operations, products and services, and improves compliance with state and federal regulations. The availability of low-cost payroll services increases adoption by small businesses, who benefit from affordable expert support for this complex non-core administrative function.

Payroll as a service should be broadly available at a reasonable cost to encourage small businesses to adopt these services. Requiring all payroll servicers to become licensed money transmitters creates high barriers to entry that will have the unintended consequence of potentially driving out many existing payroll processors that currently provide critical services to small businesses. Reducing competition in the industry would negatively impact small businesses as well as those employed by small businesses who rely on accurate payroll services. For those payroll processors who manage to obtain the necessary licenses, the cost of the payroll processor's services to their end-user business customers may increase in order for the company to bear the costs of multistate MSB licensing and ongoing annual renewal, surety bond, and compliance costs.

Lack of options for payroll services, or significantly increased costs for payroll services, would lead businesses to face difficult decisions. Businesses who cannot afford to pay the high costs of large incumbent payroll processors may attempt to bring the function in-house. Bringing the payroll function in-house where a company does not have the requisite expertise could lead to errors that negatively impact employees. Worse yet, certain businesses may choose to move to cash payroll in an effort to keep payroll off the books.

The model state MSB law should specifically exempt payroll services to encourage robust competition in the industry and protect small businesses that rely on this important service.

## Policy

The first outstanding question is notable as the option selected will likely impact the adoption of the model state MSB law by states. As stated in the Scope section of the Executive Summary, the model law should only apply to companies that are interested in operating on a national scale. Netchex appreciates the complexity around bifurcating, and attempting to harmonize, the applicability of the model law language and existing MSB laws. While the company cannot predict which of the three options listed by CSBS is best, the third option involving replacing existing state laws does not appear to be the most efficient means of encouraging adoption by states.

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<sup>1</sup> <https://www.sba.gov/sites/default/files/advocacy/2018-Small-Business-Profiles-US.pdf>.



Adopting the model language as an overlay of existing state law, or inserting the model law into existing state laws as an alternative means of compliance, are both options that Netchex believes would be welcomed by industry participants. Retaining existing state laws allows the states to preserve familiar regimes that address unique differences that evolved from experience with various participants in different jurisdictions and provides consistency for entities already licensed in certain states. Whatever option is eventually selected, companies should have the option to transition from a current state license to a multistate license as operations or general business plans evolve.

### Activity Definitions

The Fintech Industry Advisory Panel shared an important point when it described industry’s difficulty with interpreting how “money services” are defined and which activities are exempt state-to-state. Differences in definitions and interpretations of money transmission laws among states escalates compliance issues for the industry. The second outstanding question of how states should ensure consistent interpretation of definitions likely has a variety of answers.

Regardless of the specific course chosen, ensuring consistent interpretation of definitions will likely involve ongoing efforts. Establishing a multistate committee that reviews novel definition questions regarding what does and does not constitute “money transmission” should be considered since the payments industry and related technology is continuously changing, and it is not possible to conceive of every situation to which a definition might need to apply in the future. Such a committee could publish questions and answers in a central location for industry participants to reference.

### Control

The final outstanding question, listed in the Control section, asks how states can leverage the multistate licensing agreement to remove repetitive licensing practices that do not address a corresponding risk. First, we commend the states for their use of the Nationwide Multistate Licensing System & Registry (“NMLS”) as a central repository for application items, and we encourage expanded use of NMLS wherever possible to remove repetitive licensing requirements. As to the multistate licensing agreement, we believe that the more uniform state MSB licensing laws are, the more one state can take the lead in reviewing and approving an application. We do not expect one state to become an expert in another state’s laws and therefore understand under the current regime that Washington, for example, cannot certify that an applicant has met Texas-specific application requirements. However, as the state-specific requirements are reduced or eliminated, more application items can be reviewed and approved by the lead state under the multistate licensing agreement, therefore we believe that working towards uniformity in state laws will be the best way to allow the multistate licensing agreement to remove repetitive licensing practices. Companies should not be unduly burdened by repetitive tasks that do not address a clear and specific risk.

The Executive Summary currently states that the draft model state MSB law retains state background check requirements because several states have preexisting state background check requirements. Instead of retaining this time intensive requirement, CSBS should conduct an analysis of FBI background checks versus state background checks which could shed light on whether there is any actual benefit from requiring the separate



state background checks. State background checks may not be necessary if it can be established that FBI background checks are more comprehensive and can be utilized by individual states to provide the type and level of information that the states require in state-specific background checks.

### Financial Condition

We appreciate the working group's openness to new approaches to assessing a company's financial condition, and agree that financial condition requirements should be dynamic and measured in relation to a company's balance sheet. While Netchex prefers the Three-Legged Stool approach, we would like to focus our financial condition comments on the surety bond requirement specifically.

While addressed differently under the "Three-Legged Stool" and "Suspension Bridge" approaches to financial condition, surety bond requirements warrant additional considerations. Surety bonds may not be the most effective means of establishing a safety net for consumer loss and the cost of a receivership should a licensed MSB entity fail or otherwise not be able to meet its customer obligations. Looking to how other industries address similar risks may provide approaches and options that have not yet been considered.

One alternative to the surety bond requirement is the idea of a victim's compensation fund. This idea comes from medical malpractice and is intended to balance the needs of both doctors and patients. Indiana is an example of a state that has a "Patient's Compensation Fund." In Indiana, as part of the Indiana Medical Malpractice Act<sup>2</sup>, there are caps on the amount of damages that a patient can recover for injuries suffered as a result of medical malpractice. The doctor's contribution is capped at \$500,000. If the patient's damages exceed this amount, they may recover up to an additional \$1.3 million from the state of Indiana through the Patient's Compensation Fund. In this way, the Patient's Compensation Fund is an attempt to keep physicians' insurance costs down while at the same time guarantee that patients recover money they need and deserve when they have been harmed by medical malpractice.

We believe a "MSB purchaser's compensation fund" could similarly balance keeping MSBs' surety bond costs down while also guaranteeing that purchasers of money services are able to recover any money that is lost if a MSB fails or is otherwise unable to meet its customer obligations. In the case of a MSB failure or inability to perform, it is likely that the licensed company's surety bond(s) will not cover all of the harm suffered by customers. Surety bonds are currently capped at a few million dollars per state at most, and many states have much lower bond requirements. While maintaining these surety bonds is a significant expense for MSBs, they are likely insufficient to make customers whole. Therefore a "MSB purchaser's compensation fund" could strike the correct balance by keeping the MSBs' costs for surety bonds down – say by creating a scalable surety bond requirement paid into a state-operated compensation fund annually and capped per state based on the size of the payroll company – while at the same time making it more likely that customers will be made whole since they will be able to draw on the compensation fund once the surety bonds are extinguished.

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<sup>2</sup> Indiana Code Title 34, Section 34-18-14-3.



### Coordination

While the working group is in place and addressing all issues, it would be beneficial to consider adding an explicit reciprocity provision to the model state MSB law. Reciprocity is one potential provision that is missing from the current proposal. The final model law may still be revised in different ways by states and a reciprocity component could provide significant benefit to certain businesses. Much of the impetus for developing a model MSB law is to increase uniformity of MSB laws across states, and including MSB licensing reciprocity as an option is in line with that general movement toward uniformity. The more uniform state MSB licensing laws are, the more likely states would be to grant reciprocity in licensing from other states because the state granting reciprocity can be assured that other states' MSB laws and licensing requirements are similar if not identical to the state granting reciprocity.

### *Conclusion*

Uniform MSB laws have the potential to safeguard the financial system and protect consumers/customers from potential bad actors while increasing the efficiency of obtaining money transmitter licenses by industry participants. Netchex commends the CSBS for its valuable work on creating a model state MSB law and is grateful for the opportunity to provide these comments. If there are any questions regarding our comments, please do not hesitate to contact the undersigned at 985-220-1410 or [ldubuc@netchexonline.com](mailto:ldubuc@netchexonline.com).

Sincerely,

Louis Dubuc  
Chief Financial Officer