Payments Law and Regulation Forum

June 6, 2019

Government Relations Programs for Payments Companies

Josh Raymond
Venable LLP

Jon Genovese
Worldpay

Kim Ford
First Data

Scott Talbott
Electronic Transactions Association (ETA)

Why Are Government Affairs Programs Important for Payments Companies?

- Policy makers are increasingly suspicious of large, financial institutions, and this sentiment is tracking to the population at large.
- Operation Choke Point.
- Policy issues impact payments (privacy, data breach, etc.).
- Numerous benefits that range from having the ability to shape future markets, to knowing that solid relationships are in place when the heavy "ask" comes into play.

VENABLE LLP MAC

What Are the Goals of a Government Affairs Program?

- Develop and execute a strategic government relations and regulatory affairs strategy that provides a platform to continue to build company's reputation in Washington and in the states.
- Establish and deepen relationships with key congressional leaders in both parties and with leaders in federal agencies.
- Protect current and planned business operations and preserving company position as a leading player in the payments industry.

VENABLE LLP MAC

What Are the Elements of a Government Affairs Program?

- Develop an advocacy plan for Congress and state lawmakers, but also key agencies, including the FTC, the CFPB, the OCC, the FDIC, and others. This includes establishing and maintaining relationships with agency leaders and political staff.
  - To execute a government affairs strategy, it is critical for company and its executives to establish relationships and a profile in Washington.
  - This is often done by focusing on those representatives and senators who represent cities/states in which company has facilities, especially if any such representative or senator serves on a committee most pertinent to company's business.
  - This would include bolstering relationships with chairmen and ranking minority members (and/or senior staff) of those pertinent committees.

VENABLE LLP MAC

What Are the Elements of a Government Affairs Program?

- Monitor and respond to political, legal, and regulatory developments.
  - Starting point is to identify issues that are of primary concern to company's current and planned business operations, assess how federal and state developments may impact those issues, and then develop an initial plan to protect company's interests in the short and long term.
  - This would include tracking and analyzing key legislative and regulatory issues and developments related to substantive issues important to company's business.
- Leverage key trade associations (such as the Electronic Transactions Association).
- Maintain a political action committee.

VENABLE LLP MAC

Federal Agencies Relevant to Payments Industry

Consumer Protection/Privacy	Data Security	AML/OFAC	Financial Institutions
Federal Trade Commission	Federal Trade Commission	Financial Crimes Enforcement Network	Federal Deposit Insurance Corp.
Consumer Financial Protection Bureau	Consumer Financial Protection Bureau	Office of Foreign Assets Control	Federal Financial Institutions Examination Council
Dept. of Justice	Federal Financial Institutions Examination Council	State Banking Regulators	Comptroller of the Currency
State AGs	U.S. Secret Service	New York Dept. of Financial Services	National Credit Union Admin.
State Banking Regulators	Card Brands		Federal Reserve
Card Brands			

VENABLE LLP

MAC

Federal Agencies Relevant to Payments Industry

Payments Service	Enforcement	Examination	Rulemaking
Payment Processing	CFPB / FTC / DOJ Federal Banking Regulators	CFPB / FFIEC	CFPB / Card Brands / State Regulators
Money Transmission	FinCEN / OFAC CFPB State Regulators	FinCEN / CFPB State Regulators	FinCEN / OFAC CFPB State Regulators
Prepaid	CFPB	CFPB	CFPB
Add-On Products	CFPB / FTC / DOJ	CFPB	CFPB
Mobile and E-Commerce	CFPB / FTC	CFPB	CFPB / Card Brands
Data Security	FFIEC / CFPB FTC	FFIEC	FFIEC / CFPB Card Brands
Consumer Reporting	CFPB / FTC	CFPB	CFPB

VENABLE LLP

MAC

House and Senate Committees

House Financial Services Committee	Senate Banking Committee	House Judiciary Committee	Senate Judiciary Committee	House Energy & Commerce Committee	Senate Commerce Committee
CFPB	CFPB	DOJ	DOJ	FTC	FTC
FFIEC	FFIEC				
OCC	OCC				
Federal Reserve	Federal Reserve				
FDIC	FDIC				
NCUA	NCUA				
OFAC	OFAC				
FinCEN	FinCEN				

VENABLE LLP MAC

House and Senate Caucuses

Congressional FinTech and Payments Caucus Chair/Co-Chairs	Senate Payments Innovation Caucus Chair/Co-Chairs
David Scott (D-GA)	Johnny Isakson (R-GA)
Barry Loudermilk (R-GA)	Tom Carper (D-DE)
	Mike Rounds (R-SD)
	Gary Peters (D-MI)

VENABLE LLP MAC

Understanding Payment Facilitators and Marketplaces

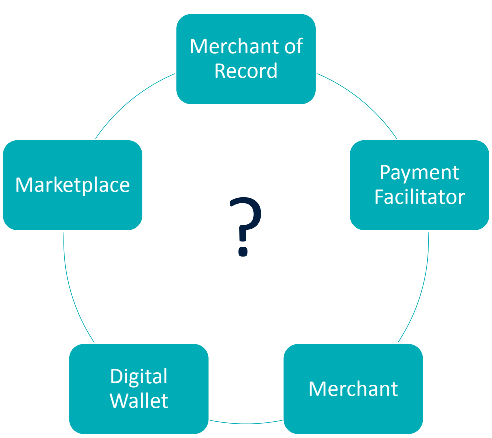
Andrew Bigart
Venable LLP

Dan Spalinger
Rich Consulting

Sam Sherzad
Five Stars Loyalty

VENABLE LLP MAC

The Payments Ecosystem



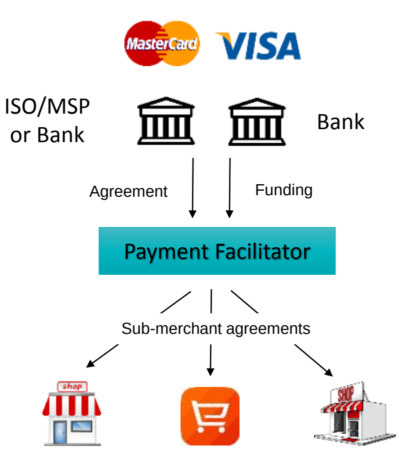
VENABLE LLP MAC

What Is a Payment Facilitator?

- A payment facilitator is a merchant that operates a sub-merchant platform.
  - PF opens a MID (merchant ID number) through a Visa / MC acquiring bank or ISO/MSP.
  - PF establishes a relationship with a gateway / processor to process transactions.
  - PF sets up an underwriting and boarding process for sub-merchants (subject to card brand and acquirer requirements).
  - PF signs up sub-merchants through its MID, usually on an expedited basis.
    - Simple online application
    - “Frictionless boarding” / “just-in-time” underwriting
  - Sub-merchants process under the PF’s MID.

VENABLE LLP MAC

Payment Facilitator Overview



Vertical PF

- Focuses on one industry (running races, food service, medical offices)
- Example: RunSignUp, Fivestars
- Value-added services (example: enrollment, race management, race-day tools, reporting)

Horizontal PF

- Provides the payments engine for any type of merchant
- Should be signing up small / micro-merchants
- Examples: Stripe, Square, WePay
- Value-added services (ex: subscription services, e-commerce platforms, reporting)

VENABLE LLP MAC

Payment Facilitator Responsibilities

- General card brand requirements:
  - Must contract with acquirer to provide services to sub-merchants.
  - Must be registered, maintain good standing, and meet financial requirements.
  - Must have a merchant agreement with each sub-merchant.
  - Must perform initial and ongoing diligence on sub-merchants, including monitoring to ensure compliance with applicable standards.
  - May not process payments for another PF.
  - May only use settlement funds to pay sub-merchants and not for any other purpose.
  - Must not contract with a sub-merchant outside the country in which the acquirer is located.
  - Must be PCI compliant.

VENABLE LLP MAC

What Is a Merchant of Record?

- In a card transaction, the merchant of record (MOR) is the company that sells the product or service to the buyer.
- According to Visa's rules, the MOR is the company that (1) represents itself as selling the goods or services to the cardholder; (2) uses its own name to identify itself to the cardholder; and (3) provides recourse to the cardholder in the event of a dispute.
- Other factors indicating a company is the MOR include the following: it takes possession of the goods or services to be sold, books the sale as revenue, or provides customer service and handles returns.

VENABLE LLP MAC

What Is a Merchant of Record?

- Where a company hosts a platform for facilitating the purchase of goods and services from multiple unrelated sellers, how can it be considered the MOR?
  - In this scenario, the company may purchase and take title to the stock of sellers on the platform prior to the platform company selling it to the buyer.
  - For a platform that provides services, the platform may treat the individual service providers as its employees or independent contractors.
  - When a buyer uses a service through a platform, such as a car ride or repairs, they are contracting with and making payment to the platform company, which has the separate obligation of paying its employees and contractors.

VENABLE LLP MAC

What Is a Marketplace?

- Visa recently defined a "marketplace" to mean a company that:
  - (1) provides an electronic commerce website or app to bring buyers and sellers (called "retailers") together; and
  - (2) manages payments on behalf of the retailers on the marketplace by processing them through its own merchant account.
- The other card brands are likely to publish their own rules defining a "marketplace," but currently a marketplace for Visa's purposes may still be treated as a payment facilitator under the other card brands' rules.

VENABLE LLP MAC

What Is a Marketplace?

- Under the Visa Rules, a marketplace is similar to a payment facilitator, but may only process the transactions of the retailers on its platform.
- In addition, whereas payment facilitators have the flexibility of having their processors settle directly to sub-merchants, the Visa Rules require a marketplace to receive and distribute settlement funds to the retailers on its platform.
- Visa also places limits on the size of the retailers on a marketplace's platform and imposes certain customer service and dispute resolution obligations on marketplaces.

VENABLE LLP MAC

What Is a Staged Digital Wallet?

- An SDWO is company that provides digital wallet services involving:
  - (1) a funding transaction paid by debit or credit card to the SDWO and processed through its merchant account; and
  - (2) a separate payment transaction from the SDWO to the merchant from which the cardholder wants to make a purchase that does not involve the use of the card.
- Although the merchant receives payment in the second step, it may not receive any information about the buyer's credit or debit card.
- Rather, the merchant is paid through a funds transfer from the SDWO to its bank account or through a proprietary stored value system from which the merchant may withdraw funds to its bank account.

VENABLE LLP MAC

What Is a Staged Digital Wallet?

- Like a payment facilitator or a marketplace, an SDWO must be specifically registered with the card brands and is subject to their rules as both a merchant and a third-party agent / service provider.
- Because a SDWO provides both fund transfers and stored value services, it is the aggregator type most likely to have significant money transmission licensing and compliance problems.

VENABLE LLP MAC

Understanding the Differences

Issue	Merchant of Record	Payment Facilitator	Marketplace	SDWO
Software	No specific software required.	No specific software required.	E-commerce website or mobile app that brings together cardholders and retailers.	No specific software required.
Eligible Transactions	To qualify as MOR, company must be the seller of the goods and services.	Only transactions involving a sub-merchant with which the PF has an agreement.	Sales transactions of retailers on its retail platform.	No specific requirements, but merchant must agree to accept payment from the SDWO.
Settlement	Funds settle to MOR's account, no additional disbursement.	May receive settlement for distribution to sub-merchants or have bank settle directly to sub-merchants.	Must receive settlement on behalf of its platform retailers and distribute funds.	Transactions settle to SDWO, which may distribute to an identified merchant or hold funds for future transactions.

VENABLE LLP MAC

Understanding the Differences

Issue	Merchant of Record	Payment Facilitator	Marketplace	SDWO
Size Restrictions	No specific limitations.	PF's sub-merchants must sign an agreement with the processor/bank after exceeding $1 million in annual volume.	No platform retailer may (1) have more than $10m in Visa volume through the MP; or (2) have more than 10% of the MP's annual Visa volume.	No specific limitations.
Dispute Resolution	Sets terms and conditions for transactions and is responsible to cardholder for returns, refunds, and dispute resolution.	N/A	Financially liable for and must resolve disputes between cardholders and retailers.	No specific requirements.

VENABLE LLP MAC

State Issues Impacting Payments

Deron Hicks
TSYS

PJ Hoffman
Electronic Transactions Association (ETA)

Megan Howell
PayPal

David Leppek
Executive Payment Consultant

VENABLE LLP MAC

State Law Impacts on Payments

- Many of the laws and regulations that impact payments are found at the state level:
  - Data breach
  - Privacy
  - Tax Issues
  - At-the-Register
- State developments can have significant impacts on the payments industry; these laws sometimes target the payments industry directly, but often can impact payments indirectly.
- In-house counsel and government affairs teams should keep track of these developments and leverage trade associations (e.g., Electronic Transactions Association) to ensure that their business interests are represented.

VENABLE LLP MAC

Data Breach

- Many states, including California, Illinois, Michigan, Missouri, New York, and Pennsylvania, are considering or have considered amendments to existing law that require holders of certain types of data to provide notice of data breaches.
  - I.e., Expansion of PII definitions, shorter notification timelines, and AG notification
- In California, for example, a pending bill would require a person or business that owns or licenses computerized data that includes personal information to disclose any breach of the security of the system within 72 hours following discovery or notification of the breach, subject to the legitimate needs of law enforcement.
- In this legislative session, several states have enacted changes to their data breach notification laws, including Arkansas, Maryland, New Jersey, and others.
- This issue is also being considered at the federal level, as Congress determines whether to pass federal data breach requirements to preempt a patchwork of state laws.

VENABLE LLP MAC

Privacy

- There are many states considering laws aimed at protecting consumer privacy.
- Since passage of the California Consumer Privacy Act (CCPA), a number of states have introduced similar bills in 2019:
  - Hawaii
  - Illinois
  - Maryland
  - Massachusetts
  - Mississippi
  - New Mexico
  - New York
- Many other states (more than half) are considering privacy-related laws, including California, Connecticut, Illinois, Massachusetts, New Hampshire, Nevada, New York, Rhode Island, and Texas.

VENABLE LLP MAC

Tax Issues

- Marketplaces
  - There are numerous states exploring laws that will govern the collection of use tax by marketplace facilitators. Many of these bills have not included specific exemptions for payment processors.
    - Arizona, California, Kansas, Missouri, and Vermont
  - Several states have enacted marketplace laws or are in the process or enacting laws that have payment processor exemptions.
    - Indiana, Nebraska, Maryland (before Gov.), Virginia, West Virginia, and others.
- Real Time Sales Tax
  - Some states (Connecticut, Massachusetts, Missouri) have introduced real time sales tax bills that would require payment processors to collect and remit sales tax for online purchases.
- 1099-K Reporting
  - Numerous states (California, Illinois, and Massachusetts) have considered bills relating to 1099-K federal tax form reporting.

VENABLE LLP MAC

At-the-Register

- Surcharging
  - Some states have bills that would prohibit retailers from imposing a surcharge on consumers for the use of a credit card, while others would allow for surcharging.
  - Bills are pending in Massachusetts, New Jersey, New York, and Oklahoma.
- Cashless
  - States and municipalities have proposed with some success laws that prohibit merchants from going cashless.
  - Passed in New Jersey, Philadelphia, and San Francisco.
- Money Transmission
  - Various states (California, Massachusetts, New York, and Rhode Island) continue to explore additional requirements for money transmitters.
    - Disclosures for consumers of the potential for consumer fraud (New York)
    - Penalties for the knowing transmission of criminal proceeds (New York)
    - Revisions to the scope of the statutes (Massachusetts and Rhode Island)

VENABLE LLP MAC

Data Security and Privacy

How Federal and State Initiatives Impact Payments

Julia Tama
Venable LLP

Ross Nodurft
Venable LLP

Jim Bibles
Aperia

VENABLE LLP MAC

Topics

- California Consumer Privacy Act on the horizon
- State and federal data breach notification updates
- State trends in digital identity

VENABLE LLP MAC

Impact of the CCPA

- **Broadest definition of "personal information"** under any privacy law to date
- **Applies EU privacy requirements** to U.S. consumers for the first time
- Will require **significant operational and compliance effort**
- New **class action risks** associated with security breaches
- Goes into effect **January 1, 2020**

VENABLE LLP MAC

Scope of CCPA

Any company that does business in California and meets one or more of these standards:

- Annual gross revenue over $25 million
- Collects or shares personal information annually from 50,000 consumers, households, or devices
- Derives at least 50% of annual revenue from sale of personal information

Obligations and limitations extend to all **personal information** maintained about **consumers**.

- Consumer = any natural person who is a California resident
- Personal Information = information that identifies, relates to, describes, is capable of being associated with, or could reasonably be linked with consumer or household

VENABLE LLP MAC

GLBA and CalFIPA Exemptions

CCPA generally supplements other federal and California state privacy laws.

- But contains specific exemptions for some state and federal privacy laws.
- As amended, CCPA does not apply to personal information *collected, processed, sold, or disclosed pursuant to* the Gramm-Leach-Bliley Act (GLBA) and the California Financial Information Privacy Act (CalFIPA).
- This exemption does not extend to the private right of action arising from data security breaches.

VENABLE LLP MAC

Key CCPA Requirements

- **Access:** Consumer right to request certain information about practices, *and specific pieces of personal information*
- **Deletion:** Consumer right to request deletion of personal information, with some exceptions
- **Opt-out:** Consumer right to opt out of "sales" of personal information
  - Sale = any disclosure of personal information for "consideration"
  - "Do Not Sell My Personal Information" links on webpages
- **Non-discrimination:** Business cannot discriminate based on exercise of consumer rights

VENABLE LLP MAC

Attorney General Enforcement

California attorney general enforcement.

- Businesses have a 30-day cure period after being notified.
- Can seek an injunction plus civil penalties of up to $2,500 per violation and up to $7,500 per intentional violation.

Considerations.

- No cap on civil penalties.
- Attorney general is incentivized to seek enforcement – penalties and settlement proceeds placed in state fund.

Rulemaking.

- By July 1, 2020, the attorney general will adopt regulations as directed by the CCPA.
- Topics include rules and procedures for "sales" opt-outs, verifiable consumer requests.

VENABLE LLP MAC

Private Right of Action

Unreasonable security and

PI subject to unauthorized access and

exfiltration, theft, or disclosure

Encryption and redaction exception

Different definition of personal information for this section, limited to individual's first name/initial, plus last name, plus:

Social security number	Driver's license or state identification card number	Financial account number, credit or debit card number in combination with access code	Medical information	Health insurance information

VENABLE LLP MAC

State Data Breach Notification Laws

- All 50 states, the District of Columbia, Guam, Puerto Rico, and the Virgin Islands have enacted data breach notification laws that require businesses and/or governments to notify consumers if their personal information is breached.
- In 2019, at least 19 states are considering measures that would amend their existing laws.
- Trends in these updates include:
  - Expanded definitions of "personal information"
  - Setting or shortening reporting time frames
  - Requiring reports of breaches to state attorneys general
  - Providing for free credit freezes for individuals affected by breaches

VENABLE LLP MAC

Federal Data Breach Notification Debate

- There has long been debate over adoption of a broad federal data breach notification standard.
- In September 2018, the House Financial Services Committee passed Rep. Luetkemeyer's Data Security and Notification Requirement Bill (H.R. 6743).
- However, the Congress ended without any further movement.
- In 2019, Chairman Maxine Waters (D-CA) took over the Financial Services Committee and shifted her focus to consumer protections.
- On May 8, 2019, the Consumer Bankers Association sent a letter to the Senate Commerce Committee calling for federal data security and breach notification standards.
- Right now, it seems unlikely that this Congress will pass a data breach notification standard that is not included as part of a larger privacy bill.

VENABLE LLP MAC

State Trends – Digital Identity and Payments

- As of March, there are 15 states either developing, piloting, or considering digital driver's licenses.*
- Additionally, states are looking to digital identity solutions to address critical changes in the healthcare industry.
  - E.g., at least six states have mandated use of the electronic prescriptions for controlled substances (EPCS) system.

VENABLE LLP MAC

State Trends – Digital Identity and Payments (continued)

- Specifically in the payments space, the Conference of State Bank Supervisors (CSBS) announced in February that it will begin implementing a series of recommendations from its FinTech Advisory Panel. Highlights include:
  - Developing a 50-state model law to license money services businesses
  - Creating a standardized call report for consumer finance businesses
  - Building a database of state licensing and fintech guidance (encourage a common standard)
  - Developing a State Examination System
  - Expanding the use of the Nationwide Multistate Licensing System

VENABLE LLP MAC

Drafting Contracts to Minimize Risk

Kate Root
Chesapeake Bank

Theresa Kananen
Arnall Golden Gregory LLP (AGG)

Evan Minsberg
Venable LLP

VENABLE LLP MAC

Summary of Issues in Contract Negotiation

Issues	
Risk of Loss • Determining liabilities on each side • Reserve accounts • Set-off rights • Non-compliance fees	Customer Ownership • Merchant/sub-merchant relationship Ownership • Data ownership • Non-solicitation
Term and Exclusivity Provisions	Exit Rights • Assignability • Change in control • Sponsor transfer rights • Wind-down period
Oversight, Audit, and Approvals	

VENABLE LLP MAC

Risk of Loss

Issue	Acquirer / Processor	Payment Facilitator / Fintech / Merchant
Liability	• Focus on counterparty's liability. • Pass down liability for chargebacks, card brand fines. • Address liability for system outages.	• Make compliance requirements mutual. • No liability for losses caused by acquirer/processor (1) gross negligence; (2) willful misconduct; (3) violation of law or agreement. • Push for SLAs.
Reserve Accounts	• Push for leeway in maintaining a reserve • Require definite end date for reserve funds to be held (e.g., 12 months after end of processing relationship).	• Push for no reserve account until specific triggering event. • Preference for opening own interest-bearing account and providing security interest.
Set-off Rights	• Absolute requirement.	• Largely unavoidable, not worth negotiating.
Non-Compliance Fees	• Liability for fines imposed by government agencies or card brands should be pushed down. • If processor intends to assess non-compliance fees on its own, make sure they are clearly disclosed.	• Push-back on non-compliance fees. • Should not be used as revenue generation tool.

VENABLE LLP MAC

Term and Exclusivity

Issue	Acquirer / Processor	Payment Facilitator / Fintech / Merchant
Term and Exclusivity	• Preferred 5 years and exclusivity. • Market is closer to three years non-exclusive.	• 3-year max term if deal is exclusive. • Non-exclusive agreement is preferred.

VENABLE LLP MAC

Oversight, Audit, Approvals

Issue	Acquirer / Processor	Payment Facilitator / Fintech / Merchant
Oversight, Audit, Approvals	• Push for audits on demand, at processor's expense. • Written approval requirements for sub-merchant agreements, material service providers, and marketing collateral. • Determine credit criteria and merchant approval process early, potentially through addendum.	• Annual audit right unless requested by regulator or card network. Audit at expense of acquirer/processor unless requested by regulator or card network. • Approval requirements generally not worth negotiating heavily. • Specific credit criteria and ability to onboard without separate approvals should be determined as early as possible.

VENABLE LLP MAC

Customer Ownership

Issue	Acquirer / Processor	Payment Facilitator / Fintech / Merchant
Merchant / Sub-Merchant Relationship	• Address on the front end what happens if PF wants to move merchants. • Address effect of transiting merchants on residuals, etc.	• Maintaining ownership of the relationship is a high priority. • PF / fintech brings the customers to the relationship, need to maintain rights.
Data Ownership	• Negotiation of permitted uses is key, including post-termination retention. • Application and merchant data should be available to processor on request and through audit; maintain a contractual right to demand visibility of merchant relationships on request. • Be sure PF is aware of and compliant with PCI DSS.	• Transaction data could be reasonably claimed by all parties; better to negotiate permitted use on each side. • Application and merchant data should be owned by PF / fintech.
Non-Solicitation	• Want to avoid PF soliciting merchants to leave processor to board with someone else. • Non-solicitation limited to processing – not other bank products.	• Want to avoid acquirer / processor soliciting clients for direct relationship during and within 6-12 months of termination. • Limited to services contemplated in agreement – not all bank products.
Assignability / Change in Control	• Key notice events: CIC, bankruptcy, change in products or services. • Notice and approval should be geared toward material changes in business that could affect processing.	• Minimize notice and approval requirements for change in control. • No termination for assignment if based on change in control. • Preserve flexibility for exit transaction.

VENABLE LLP MAC

Sponsor Transition and Wind-Down

Issue	Acquirer / Processor	Payment Facilitator / Fintech / Merchant
Sponsor Transition and Wind-Down	• High priority. • Ensure receiving bank is competent to take on role of acquirer. • Counterparty should be responsible for expense.	• High priority - Need to have right to transition merchant customers to new acquirer and cooperation from existing acquirer. • Need to have 6-12-month wind-down period.

VENABLE LLP MAC

Understanding and Mitigating Litigation and Enforcement Risk

Ellen T. Berge
+1 202.344.4704 | etberge@Venable.com

Leonard L. Gordon
+1 212.370.6252 | lgordon@Venable.com

VENABLE LLP MAC

Law Enforcement Activity

Payments

VENABLE LLP MAC

FTC "High Risk" Merchant Categories (unofficial list)

- Moneymaking opportunities
- Credit repair
- Credit card protection
- Identity theft protection
- Debt collection, debt counseling, debt settlement, or debt consolidation
- Mortgage or loan modification
- Government grants
- Time-share resale
- Telemarketing
- Mastercard / Visa registered high risk
- MATCH-listed merchants
- Merchants that process more than 15% of their sales and at least $200,000 in sales through card-not-present transactions on an annual basis

VENABLE LLP MAC

FTC "High Risk" Goods and Services (unofficial list)

- Cryptocurrency
- Discount buying clubs
- Foreclosure protection or guarantees
- Lottery sales or sweepstakes
- Medical discount benefits packages including discount medical cards
- Multilevel marketing distribution
- Nutraceuticals
- Penny auctions
- Real estate seminars and training programs
- Computer technical support services
- Goods or services with negative option features (trial offers; subscriptions)

VENABLE LLP MAC

Credit Card Laundering

- Unfair practice under the FTC Act
- FTC Definition:
  a) Processing a transaction that is not the result of a sale between the cardholder and the merchant of record;
  b) Employing, soliciting, or otherwise causing or allowing a merchant to process a sales transaction that is not the result of a credit card transaction between the cardholder and the merchant of record; or
  c) Obtaining access to the credit card system through the use of a business relationship or an affiliation with a merchant, when such access is not authorized by the merchant account agreement or the applicable credit card system.

VENABLE LLP MAC

Shell Companies and Straw Owners

- Unfair practice under the FTC Act
- Often tied to a particular merchant, sales agent, or other referral source
- Capability of opening hundreds of accounts with hundreds of different owners
- Submit falsified and forged information to payment processing entities
- Processor is often victim

VENABLE LLP MAC

What Does Law Enforcement Look For?

- Making false statements to obtain payment processing services
  - About geographic location, name, identity, or corporate form of merchant
- Failing to disclose to processing partners (banks, ISOs, etc.) material information about a merchant account, such as:
  - the identity of any owner, manager, director, or officer of the applicant for or holder of a merchant account, and
  - any connection between an owner, manager, director, or officer of the applicant and a person who was previously terminated (due to chargebacks, fraud, questionable merchant status, merchant collusion, illegal transactions, or identity theft)
- Using tactics to avoid fraud and risk-monitoring programs
  - Load balancing sales transaction volume among multiple merchant accounts or merchant billing descriptors;
  - Splitting a single sales transaction into multiple smaller transactions; or
  - Using a shell company to apply for a merchant account.

VENABLE LLP MAC

Criminal Law Enforcement

- Department of Justice, U.S. Postal Inspection Service, Department of Treasury's Office of Foreign Assets Control (OFAC)
  - Conspiracy
  - False statements to a bank
  - Wire fraud
  - Bank fraud
  - Participating in fraudulent banking activities
  - Conspiracy to commit money laundering
  - Money laundering
- Grand jury subpoenas
- PacNet Case (September 2016)
  - Designated as a significant transnational criminal organization (TCO) for processing for fraudulent/criminal direct mail scheme

OFAC

VENABLE LLP MAC

Key Policy Issues in 2019

Processor Liability ($)

- FTC seeks the full volume of sales transactions processed (less chargebacks and refunds)
- Example: $50 million sales processed = $50 million potential liability
- Cases often settle for less based on defendants making an "ability to pay" argument
  - Requires turnover of comprehensive financial statements completed on behalf of corporate and individual defendants
- FTC v. Universal Processing Services (11th Circuit) (December 2017)
  - Processors that collaborate with fraudulent merchants can be held jointly and severally liable for the full amount of sales processed by the merchant
  - The court rejected arguments that, in order to be held jointly and severally liable, a processor must be part of a "common enterprise" with the merchant

Reserve Funds

Question: Who owns the funds in a reserve account?

Pick the best answer:

(a) The acquiring bank

(b) The processor

(c) The merchant

(d) Consumers

VENABLE LLP MAC

Reserve Funds

U.S. District Court – Middle District of Florida (2018) determined the merchant owned the funds because:

1. The Merchant Agreement provided that "Merchant grants Bank security interest in each Charge and . . . the Reserve Account."
   - Merchant can grant a security interest in the reserve account funds only if it is the owner of the fund.
2. The Merchant Agreement provided that "[i]f funds are not available in the Settlement Account, Bank without prior notice to Merchant may deduct from the Reserve Account."
   - If the merchant did not own the reserve account funds, this provision would not be necessary.
3. Merchant Agreement provided, "Without limiting Bank's other remedies or Bank's security interest . . . Merchant Bank may deduct, debit and withhold the amount of a Chargeback or anticipated Chargeback from the Settlement Account, Reserve Account, or any Merchant Account at Merchant Bank, or other ***property of Merchant held by Bank***[.]"

VENABLE LLP MAC

Limits on the FTC's Authority

- Cases against processors filed under Section 13(b) of the FTC Act.
  - Authorizes the FTC to seek a permanent injunction only.
  - Subject to aggressive use by FTC over the years to seek a full range of equitable remedies available to a court, including power to grant consumer redress and compel disgorgement of profits.
- Judges and courts are battling back.
    - The ability of the FTC to obtain an injunction under Section 13(b) is severely limited.
  - *Federal Trade Commission v. Hornbeam Special Situations, LLC*, No. 1:17-cv-3094 (N.D. Ga. Oct. 15, 2018)
  - *Federal Trade Commission v. AMG Capital Management, LLC*, 910 F.3d 417 (9th Cir. 2018) (concurrence)
  - *Federal Trade Commission v. Shire ViroPharma, Inc.*, ___ F.3d ___, 2019 WL 908577 (3d. Cir. 18-1807) (Feb. 25, 2019)
- To even get into court, the FTC must show that a processor "is" violating the law or "is about to violate the law."
- Difficult to show when the processor has already terminated the merchant.

VENABLE LLP MAC

Areas of Focus: Cryptocurrencies and Blockchain

The Future of Payments

Ed Wilson
Venable LLP

Greg Pesci
Spera, Inc.

Amit Sharma
FinClusive Capital

VENABLE LLP MAC

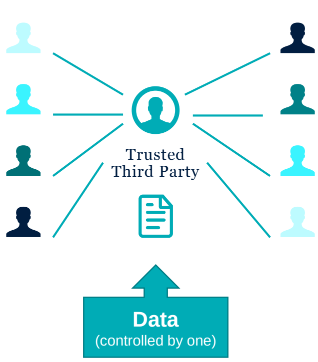
Blockchain Basics

- It started with Bitcoin, but has become much more
- Blockchain is a type of shared electronic database or ledger, which is also called distributed ledger technology or "DLT"
- Four essential features:
  - Distributed
  - Consensus
  - Immutable (cannot be changed)
  - Transparent
- A blockchain can be used to store any type of information
- There are more than 1600 digital currencies

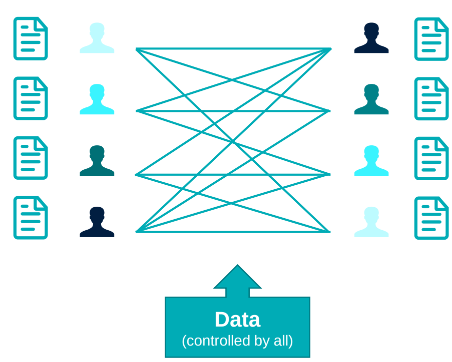
VENABLE LLP MAC

How It Works

The Trusted Third Party Solution



The Distributed Ledger System



VENABLE LLP MAC

Bitcoin Is Not Blockchain

- Bitcoin was invented in 2008 as a blockchain-based non-governmental, global "currency"
- Transparent: Open source code
- Secure: Cryptographic; large, incentivized support
- Supply/demand-driven price
- After Bitcoin (2008), developers soon found other uses
  - R3 (2014)
  - Ethereum (2015)
  - Filecoin (2017)

VENABLE LLP MAC

What's the Big Deal?

- Blockchain is a secure way to store and transact data
- Creation of "networks"
- No intermediary needed for data (money) exchange
- Unhackable(ish)
- Anonymous(ish) . . . sometimes
- Trustless . . . sometimes
- Lowercase "d" democratic (open source)

VENABLE LLP MAC

Types of Blockchain

- Public, such as used for Bitcoin, 51% consensus
- Permissioned, R3 is an example, controlled by a small group
- Private, used by a company, for example

VENABLE LLP MAC

Hot Topic: Initial Coin Offerings

What Is an ICO?

- Instead of issuing stock, a digital currency is sold
- Is the sale of the digital currency the sale of a security?
- The SEC has confirmed its view that ICOs are, generally speaking, securities
  - Issued 100+ subpoenas
  - Fined and forced two ICO issuers to give back funds and register
  - Courts or Congress may have final word (see *Kik Interactive v. SEC* (ICO issuer vows to fight))

VENABLE LLP MAC

How Are Digital Currencies Regulated?

Depends on the Categorization:

- If a security: Securities and Exchange Commission
- If a commodity:
  - Commodities Futures Trading Commission
  - Internal Revenue Service (Capital Gains/Losses)
- If a Substitute Currency:
  - Financial Crimes Enforcement Network for anti-money laundering purposes
  - State Regulators for Consumer Protection

VENABLE LLP MAC

World Economic Forum's Top 10 Potential Uses

1. Global payments
2. Insurance claims processing
3. Syndicated loans
4. Trade finance
5. Contingent convertible bonds
6. Automated compliance
7. Proxy voting
8. Asset re-hypothecation
9. Equity post-trade
10. Land Records

VENABLE LLP MAC

Use Case Discussion

Other Use Cases Impacting Firm Clients

Supply Chains and Logistics

Logistics companies are using distributed ledger technology to gain transparency of deliveries, shipment tracking, and shipment progress among other suppliers/distributors

Real Estate

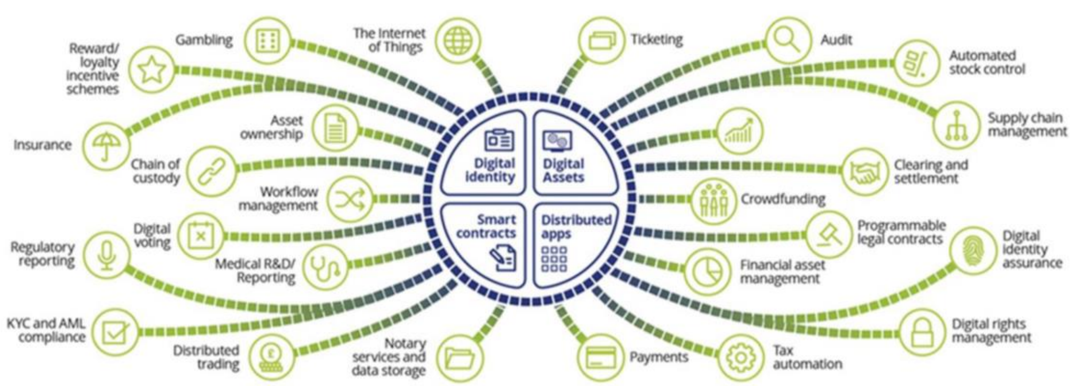
Blockchain-based solutions being explored in the real estate industry include digital identities for properties (consolidates information, such as vacancy, tenant profile, financial and legal status, and performance metric), blockchain-based smart contracts for property management systems and property loan documents, among others

Healthcare

Insurance company consortium (Aetna, Humana, Ascension, and others) using blockchain to fix errors in provider directories and lower the cost of keeping that information up to date by sharing the data and workload

VENABLE LLP MAC

Other Use Cases



Source: Deloitte

VENABLE LLP MAC

Where Are We Now? 2019

- Bitcoin down from January 2018 peak of $21,000 to current $4,000 – a drop of 80%+
- Other digital currencies have dropped as much or more
- Many 2017-era projects are dead, their coins gone to zero
- First inning over (maybe second too)
- A phase of weeding out and maturation has begun
- Our law firm didn't assist the ICO gold rush; we believe Venable is well positioned for this new phase