
Payments Pros – The Payments Law Podcast: Exploring the Potential of Georgia's Merchant Acquirer Limited Purpose Bank Charter

Host: Keith Barnett

Guest: James Stevens

Keith Barnett:

Welcome to another episode of *Payments Pros*, a Troutman Pepper podcast, focusing on the highly regulated and ever evolving payment processing industry. This podcast features insights from members of our fintech and payments practice, as well as guest commentary from business leaders and regulatory experts in the payments industry. My name is Keith Barnett, and I'm one of the hosts of the podcast.

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Today, I am joined by my colleague, James Stevens to discuss recent developments related to the merchant acquirer limited purpose bank charter, otherwise known as MALPB, and I'll be referring to MALPB throughout this entire podcast. A MALPB charter allows a company to offer merchant payment processing services without a sponsoring partner bank. Now, this is revolutionary. However, today, companies seeking to apply for the charter, which was enacted almost 12 years ago, have not been able to take advantage of its benefits because the card networks will not allow those companies to become direct participants. But that soon may be changing.

I think I forgot to mention that this MALPB charter is only available in the State of Georgia. Also, by way of background, on January 12th, a company announced that it had filed an application with the State of Georgia for the MALPB charter. Before, this particular applicant, the Georgia Department of Banking had approved an application in 2014. But as I mentioned earlier, that company was not able to get a payment card network to agree to allow it to use its rails. So here we are, 10 years later, the payments world has changed quite a bit. With more bank fintech partnerships, and banking as a service arrangement, the world seems to be ready for the MALPB in Georgia.

We're going to start this off by giving an overview of the Georgia MALPB law, the application process, application approval, and what overall will look like for a company if it decides to go through the process. For starters, a MALPB charter will allow a company to offer merchant payment processing services without a sponsoring bank as I mentioned earlier. Now, this includes obtaining membership in the card networks, signing up and underwriting merchants to accept network branded cards, facilitating the clearing and settlement of transactions through a card network. And importantly, providing access to, and sponsoring participation in card networks to the MALPB's affiliates, customers, or customers of affiliates.

Also, just to let you know, this is limited to merchant activities. A MALPB cannot operate in any manner that attracts depositors from the general public, and no deposit can be withdrawn by depositor by cheque, or similar means for payment to third parties or others. Also, a MALPB cannot accept brokered deposits as that term is defined in the FDIC Act. It's also important to know that a merchant acquirer limited purposes bank may apply to receive deposit insurance from the FDIC, but it's not required to do so.

With respect to the merchant funds, the Georgia MALPB law also addresses the merchant funds. It specifically says that all merchant funds shall constitute a trust fund until paid to the individual merchant. It also says that MALPB has a fiduciary duty to preserve and account for the merchant funds, and the MALPB should be liable for the merchant funds. A MALPB also must make appropriate deductions for chargeback fees, reserves, and other costs related to providing its services to the individual merchant. But other than that, all merchant funds must be deposited immediately by the MALPB and shall remain in an account at a financial institution that is federally insured and authorized to do business in the State of Georgia.

Now, we'll kick it over to James and see if James has any additional comments.

James Stevens:

Well, first of all, I want to thank you for the MALPB acronym, because merchant acquirer limited purpose bank charter is quite a mouthful. I think that as we've seen a lot of interest in this charter type over the past little bit, the question really is, what has changed? Why haven't there been any of these? I think that it's helpful for us to kind of walk through that because it demonstrates the possibility and maybe the uncertainty that still present today.

The trickier with this bank, and this is similar to other special purpose banks that are formed under state law is that it's an entity that's being created, that's a bank for purposes of obtaining membership and payment networks. But it's not going to be a bank that's subject to supervision and regulation by the FDIC or other federal regulator. The reason is, is because it doesn't have insured deposits. And if it doesn't have insured deposits, it's not a bank as defined by the statutes that set up supervision and regulation by those authorities. Similarly, if the bank is not a bank under those rules, then its parent company is not going to be a bank holding company that's subject to the regulation by the Federal Reserve.

The entire utility of this is that, even though it's not recognized as a bank for federal law purposes, or supervision, and regulation purposes, that it is recognized as a bank for the payment networks. What's happened in Georgia thus far is that, no bank has been able to get accepted into one of the card networks, similar to the special purpose charter that was created a few years ago over in Wyoming for crypto custody firms that really only works if the charter holders have access to an ACH network, so they can have a fiat on ramp and off ramp. If a merchant acquirer bank charter can't have access to a card network, there's really no business for it to conduct.

What's changed? Well, over the past 10 years or so, since that 2014 application that Keith mentioned, we've had questions over the years from various clients and potential clients that have looked at this charter. They found it on the books and thought this might be something worthwhile to look into. What we found throughout the past 10 years is that, when we started looking into it, is that nothing had changed from the card networks receptivity to these

applications. No one had ever gone through with the process, the public process of filing one of these applications only to be turned down by the card networks.

What happened that's changed is, around last summer, we started hearing some rumblings in the industry that there was a really large participant that was looking at getting one of these charters, and that they had a card network that had indicated that they were willing to play ball with them. We had continued to follow that throughout the last part of last year. We heard there were other large participants that were looking at this, and that potentially other card networks were coming in and considering this charter.

This all culminated as Keith mentioned, on January the 12th, when Fiserv announced that it had in fact filed one of these applications, and it became clear that Visa had been working with Fiserv in the state throughout the past some period of time preceding that filing. To give them a pretty good sense that if they were to file this application and get a charter, that membership in Visa would be something that they could obtain. The application hasn't been accepted by the state. We'll talk a little bit about that in a minute. But we think that we'll be in the coming weeks, and barring something unexpected. We don't see why a company like Fiserv would not be granted this charter. Then, we think that if Visa does in fact follow through and allow Fiserv to join its network with this charter, that others will see this as a unique opportunity to engage in merchant acquiring using this bank charter.

In light of all this recent interest, the Georgia Department of Banking and Finance, which is the regulator that regulates traditional banks in Georgia, and that will regulate these MALPBs has posted some guidance and a form of application. The guidance is really helpful. A lot will come out as the application process that Fiserv is going through is completed. But it does give us a lot of guidance on what they're looking for. One of the first things that I'll point out is there's very robust capital requirements for these charters. A MALPBs can have to have minimally \$3 million of capital, but then it's also going to have to have leveraged capital, which is its tier one capital divided by its own balance sheet assets of at least 10%.

More significantly, though, the MALPB is going to have a required minimum payment volume capital that's tied to the dollar value of the transactions that it's executing. That amount will go up, the bigger the company is, and the larger the transaction volume. Perhaps, most onerous is, the state has got what it's got, what it's calling a risk capital requirement, which is going to be something that's going to be tied to its chargeback experience. It's going to be no less than the greater of chargebacks over the previous six months, or that's forecasted chargebacks over the next six months. We also would expect that the card networks, these are we think robust capital requirements, but it's possible that the card networks could impose additional capital requirements.

As Keith mentioned, the bank charter is limited and you can't engage in other banking activities, or other activities that require licensure through this charter. You can really just engage in the merchant acquiring activities that he mentioned. So that means you can't engage in general deposit taking. You can't engage in money transmission. You can't as a fiduciary engage in trust activities. You can't make loans or credit card type transactions using payment cards or otherwise.

If you seek one of these charters, it gives you a lot of capabilities with respect to merchant acquiring. But if you want to engage in expanded activities, you're going to likely have to seek

either a broader charter or additional licenses. The rule states that a MALPB may only engage in merchant acquiring activities originating in the United States with a merchant having a physical location within the United States. A lot of the big merchant acquiring companies are working internationally. That's something that they would want to understand. The MALPB cannot be used engage in self-acquiring activities. This would be the act of a merchant for itself or through one of its affiliates engaging in merchant acquiring or settlement activities on its own behalf.

A MALPB also has to continuously employ 50 employees that reside in the state of Georgia. Finally, the mouth guidance says that anyone that's granted this charter must engage in merchant acquiring activities within one year of receiving its charter. So for example, the company that applied for this charter back in 2014, couldn't go in and start doing that business now. They would have to reapply.

The application is also very helpful. I think the form is 17 pages. We think that the application itself would be hundreds, if not, thousands of pages. And in many ways, tracks the kind of information that we're used to seeing an application to form traditional Georgia banks. For example, the key component of the application is largely a three-year business plan with financial projections, which is exactly what a traditional de novo applicant would have to file. In addition, as we see on traditional bank applications, there's going to be a very robust review of any owners, officers, and directors of the MALPB. And includes specifically a description of the requirements that the state would like to see with respect to the proposed Chief Executive Officer, Chief Risk Officer, and Chief Information Officer of a MALPB.

We've seen in the context of other bank applications, that there's certain things like having a background, where you've caused a loss to a financial institution, or engaging in certain illegal activities as being complete nonstarters for these people to be approved to be in those roles. The state has also said that they plan to render decisions on these applications within 90 days of acceptance, which exactly lines up with what they have said they seek to do, and what we have seen them actually do in connection with de novo applications.

Now, I will say that earlier, I said that the Fiserv application hasn't been accepted. What we are used to seeing in the context of traditional banks, is that the process of the beginning before acceptance could itself be 30, 45, 60 days. The entire regulatory approval process is not going to be 90 days from beginning to end. It's going to be 90 days from when acceptance until the end. This is not a rule, it's an aspiration, so it could extend on past that. But what we expect to see is that, because of the similarity of the application process, and the fact that there's going to be gaps in what the guidance says, and what the application covers, until some of these applications are filed, and ultimately approved. Is that there's going to be a lot of gap filling based on the norms of practice that it's applied in the de novo context. We think that's a really helpful background for anybody that's looking to obtain one of these charters. Keith, what else are you seeing?

Keith Barnett:

Yes. The other interesting thing that jumped out to me, James is, even though this is not a traditional bank, and not a money transmitter, or anything like that. But as a part of the application process, the state of Georgia wants to see operation policies and procedures showing compliance with the Bank Secrecy Act. In particular, the process for filing SARs and

things of that nature, OFAC checks, and also a policy on Unlawful Internet Gambling Enforcement Act. Along with policies and procedures for mitigating risks, and application to join the credit card network, and things of that nature that you will typically see with a bank, back to your earlier point on that.

Also, to your point, this is a Georgia law. So one of the things that is going to stick out to the applicants that are not in Georgia or not based in Georgia is what you said earlier, James, about employing at least 50 people who are in the State of Georgia or who reside in the State of Georgia within a year after getting the application approved, and also having office space in the State of Georgia. This is revolutionary and very helpful to the State of Georgia and becoming a player when it comes to these types of charters, don't you think?

James Stevens:

I do. I think that the State Department of Banking and Finance is excellent, and great to work with, and they're open for business. I think that they would love to see unqualified applicants file these applications. This law was put on the books because of demand by the industry. But ultimately, it was passed by the legislature, and supported by the department. We think that it would be great if some banks were able to get formed. But I think, a big fallacy, or a big mistake that people shouldn't make here is if this is going to be easy. This is not sort of like a bank light. This is just a particular type of bank. The State of Georgia, again, well, great to work with, they're going to be very rigorous in reviewing these applications. Because at the end of the day, if the card networks don't have faith in the state's underwriting of the applicants in obtaining these charters, then I mean, they're not going to be open to them obtaining membership in the card networks.

We think that you will see, especially the first few of these applications, the applicants are going to get raked over the coals as they shouldn't be when they get access to this process, this merchant acquiring process. Yes, I think we also think that – while there's going to be a lot of interest in this, and we will certainly see some applications, I think that you probably shouldn't apply unless the card networks are returning your calls. At the end of the day, the charter is not worth it unless you can get access to the card network. We think that it's likely that they would approve a few of these at the beginning from very qualified organizations, and then maybe they pause, and wait and see how it works out. And then, maybe they would do more later.

I'll also say that I think that the people that we've talked to, they're not looking to eliminate their sponsor bank relationships. They're usually looking at this as sort of unhealthy alternative to put alongside their sponsor bank programs. We think that's a good way to think about it, is that, just giving the people that are in this business some more optionality and some more control over what they're doing is really positive. Keith, I should also mention to our listeners that we are uniquely qualified to help people looking at this charter really for two reasons. One is that, back in 2014, our law firm and our Troutman Pepper strategies lobbying subsidiary of our law firm, were actually instrumental in drafting the law that created this charter. Again, none of these have been formed, and so we can't say that we know all the ins and outs of how these applications are going to work and how the guidance is going to be interpreted. But we were involved from day one on the creation of the underlying law.

Second thing I would say is, like I mentioned earlier, is that this is an application to get a bank charter. I think if you have experience applying for and obtaining bank charters, that's going to

be extremely relevant. We've actually helped in formation of all the banks that have been formed in the State of Georgia since 2010. Not a lot of banks, but all the banks in that 14-year period were our clients. We think that it's important that people that are applying to these charters, considering the uncertainty about how it's going to go, and exactly what gaps are going to be filled, and how they're going to be filled. That you seek counsel from lawyers like us and consultants that have experience filing and obtaining bank charters in the State of Georgia.

Keith Barnett:

Thanks, James. That's actually perfect way to end. I don't have anything else to add. That was great. Thank you for joining me today. Thank you to our audience for listening to today's episode. Don't forget to visit our blog by going to the [TroutmanPepperFinancialServices.com](https://www.TroutmanPepperFinancialServices.com) page, so you could subscribe and get the latest updates. Also, be sure to subscribe to this podcast via Apple Podcast, Google Play, Stitcher. or whatever platform you use. We look forward to the next time.

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