Atlantic Capital

Master Disbursement Services For/Benefit/Of (FBO) Account

White Paper

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Money Services Business (MSB) is the term used by federal regulators (FinCEN) to describe and identify businesses that issue or exchange currency, checks and stored-value cards, including those entities that transmit money as part of their core business offering. Money Services Businesses must register with FinCEN at the federal level and then obtain licensure from each individual state regulatory agency that has purview over granting and administering Money Transmitter Licenses (MTLs) in their respective states. Typically, this falls under the jurisdiction of the state Banking & Finance Commission (or equivalent.) This registration and licensure process is costly and time-consuming.

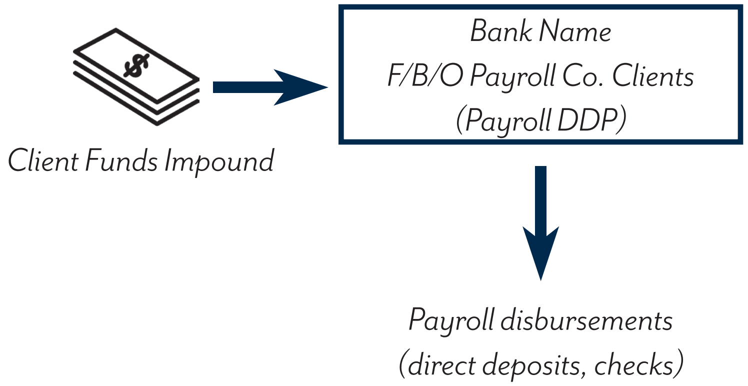
Money Services Businesses are defined in multiple ways; however a core principle is the "transmission" of funds that are not considered their own. The states have broad supervisory authority to regulate Money Services Businesses, with the core focus to protect citizens against fraud, money laundering and terrorism-financing activities.

Payroll as Money Services Business? There have been several recent instances in which state regulatory authorities have classified payroll service businesses as MSBs. Notably, the states of Texas and Connecticut have taken an active stance on this and have imposed fines on payroll firms operating in their respective states as an "unlicensed Money Services Business." This view is evolving in various states, and the challenge for a payroll company becomes complying with 50 state licensing requirements. To read the Texas statute on the Regulation of Money Services Businesses, click here.

FBO (For Benefit Of) Account – A Potential Solution: Banks by their structure and regulatory requirements serve as Money Services Businesses and are exempt from individual state Money Transmitter License (MTL) requirements. Custodial accounts that are for the benefit of certain third-party customers have been around for years, with trust and escrow accounts being the most common use. These accounts are managed by third-party service providers, who hold funds for their customers as part of their trust or escrow service. FinCEN has ruled that this type of arrangement is exempt from MTL. Therefore, it is possible to utilize an FBO account structure whereby the bank "owns" the account utilized for payroll-funds impound and payroll and tax disbursements. In this FBO-structured account, the bank's EIN is on the account and the signers on the account are bank-authorized signers. ACH files are transmitted to the bank from the payroll firm, with settlement of funds into the FBO account. This account structure has the effect of removing the payroll firm from having dominion or access over client funds allowing it to be outside of the definition of a Money Services Business.

Sample Funds Flow – F/B/O Structure

Over--



Bank:

- *Holds account/funds in Bank name*
- *Receives payment instructions*
- *Develops compliance program*

Payroll Company:

- *Provides payments instructions to Bank (NACHA, check file)*
- *Comply with bank approved compliance program*
- *Ongoing compliance/risk assessment requirements*

Pros & Cons of the FBO Account Structure: To date, FBO accounts have not been widely utilized in the payroll industry. With the changing regulatory environment, the FBO account structure may serve a useful purpose, but it comes with increased compliance obligations for the payroll firm:

Pros:

- Funds held by a federally regulated financial institution with de facto Money Transmitter Licenses in all 50 states.
- FDIC insurance applied to the individual business that has funds held in the FBO account up to FDIC insurance limit maximums.
- ACH process works as it does today, with payroll company providing payment instructions on behalf of their clients to the bank via a standard NACHA file.

Cons:

- Increased compliance requirements on part of the payroll firm, including mandatory Anti-Money Laundering (AML) and Bank Secrecy Act (BSA) policies required.
- Designation of a compliance officer & ongoing compliance training required at the payroll company.
- Required OFAC policy and ongoing OFAC client screening.
- Regular review of compliance requirements by the bank.
- Higher transaction costs.
- New bank accounts required.

Please note that this information does not constitute legal advice or a legal opinion.
Please consult your attorney for any legal advice.