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PROPOSED UIGEA REGULATIONS: BURDEN WITHOUT BENEFIT?

HEARING

BEFORE THE

SUBCOMMITTEE ON
DOMESTIC AND INTERNATIONAL
MONETARY POLICY, TRADE, AND TECHNOLOGY

OF THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

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PROPOSED UIGEA REGULATIONS: BURDEN WITHOUT BENEFIT?

Wednesday, April 2, 2008

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON DOMESTIC AND
INTERNATIONAL MONETARY POLICY,
TRADE, AND TECHNOLOGY,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:03 a.m., in room 2128, Rayburn House Office Building, Hon. Luis V. Gutierrez [chairman of the subcommittee] presiding.

Members present: Representatives Gutierrez, Waters, Sherman, Moore of Kansas, Clay, Wexler; Manzullo, Hensarling, McHenry, and Marchant.

Ex officio: Representatives Frank and Bachus.

Also present: Representatives Murphy, King, and Davis of Kentucky.

Chairman GUTIERREZ. This hearing of the Subcommittee on Domestic and International Monetary Policy, Trade, and Technology will come to order. Good morning and thank you to all of the witnesses for agreeing to appear before the subcommittee today. Today's hearing will focus on the proposed regulations to implement the Unlawful Internet Gambling Enforcement Act of 2006. These regulations were published for comment in October of 2007, and the comment period closed on December 12, 2007, with over 200 comments being received.

For our first panel, we will hear from the issuers of the proposed regulation: the Treasury Department and the Federal Reserve Board. Our second panel includes representatives from the financial services industry, and I'm betting that we will have a lively debate on this issue.

We will be limiting opening statements to 10 minutes per side, but, without objection, all members' opening statements will be made a part of the record. I yield myself 5 minutes.

The focus of today's subcommittee hearing is the proposed regulations to implement the Unlawful Internet Gambling Enforcement Act of 2006. The Act prohibits the U.S. payment system from accepting payments or bets or wagers made by U.S. citizens who seek to gamble online. The law also requires the Federal Reserve Board and the Treasury Department to issue regulations mandating that payment systems identify and block all restricted transactions.

In October of 2007, the draft regulations were issued and more than 200 comments were filed in response. As proposed, the regula-

tions would require most companies involved in the payment systems, from banks and credit card companies, to many transmitters and payment processors, to develop and implement policies and procedures designed to identify and block unlawful Internet gambling transactions.

The regulations have been widely criticized as being vague and costly for financial institutions to implement. One of the most common complaints is that the proposed rules fail to sufficiently define key terms, leaving financial institutions with significant compliance difficulties. For example, the regulation fails to adequately define what constitutes "unlawful Internet gambling" or "restricted transaction," yet requires the financial institutions to make a determination on their own about what is lawful or unlawful. If the rule is adopted in its current form, the response by many financial institutions may likely be to overblock transactions to protect themselves from legal liability. Although the regulation does provide a safe harbor for financial institutions that block transactions that are in fact legal, it does nothing to ensure that legal transactions are not blocked. As a result, consumers may be placed at risk of having lawful transactions blocked.

It is easy to see how these regulations, if implemented in their current form, could wreak havoc on electronic commerce in the United States. With that in mind, I want to take a moment to question the priorities reflected by the underlying law, which was passed while my party was in the minority, and which seeks to eliminate Internet gambling by adults. In my opinion, if Congress is going to impose additional regulations on financial institutions, our time would be better spent restricting payday lending or curbing unfair and deceptive practices associated with credit card accounts and other types of predatory lending.

But the reality is, we have a law that requires the regulators to develop rules that ban Internet gambling, and I have several concerns with the proposed rules. First, I am concerned about the effect these regulations will have on the remittances system that immigrants use to send billions of dollars home each year. Money transmitter companies are already having problems maintaining accounts with some banks, and I fear that this rule could exacerbate that problem. I am also troubled that these regulations could impose significant compliance burdens on financial institutions during a time of economic and financial turmoil.

Finally, I believe it is inappropriate to have financial institutions essentially acting as final arbiter in determining which transactions are legal or illegal, especially when the result could be closing a consumer's account. This hearing will be an opportunity for the regulators to address these and other issues concerning the proposed rules. We will also have the opportunity to hear directly from the financial services industry on the potential cost, regulatory burden, and compliance issues they anticipate if the regulation is implemented as proposed.

I expect a vigorous debate on the issues, and the subcommittee looks forward to working with the regulators as they move through the process and decide whether to amend the regulations or simply roll the dice and adopt them in their current form.

The Chair will now recognize the ranking member of the full committee and the author of the legislation, Mr. Bachus, for 5 minutes.

Mr. BACHUS. Thank you, Mr. Chairman, for holding this hearing on the regulatory implementation of the Unlawful Internet Gambling Enforcement Act. The title of this hearing deals with the regulation proposed by Treasury and the Federal Reserve, although I believe also in our minds is Chairman Frank's legislation, H.R. 2046, which would effectively repeal the ban on illegal Internet gambling that we worked so hard to enact. And I believe it of course is also material to today's hearing. I know several of my colleagues are pushing for the enactment of that legislation if they cannot, what I would call, "water down" the regulations which have been proposed by Treasury and the Fed.

I have a letter signed by 45 State attorneys general who oppose Chairman Frank's H.R. 2046 and also oppose any weakening of regulations to implement the Unlawful Internet Gambling Enforcement Act. I'm just going to read one quote from a letter that they signed. They said:

"H.R. 2046 effectively nationalizes America's gambling laws on the Internet, harmonizing the law for the benefit of foreign gambling operations that were defying our laws for years, at least until the Unlawful Internet Gambling Enforcement Act was enacted. We therefore oppose this new proposal and any other proposals that hinder the rights of the States to prohibit or regulate gambling by their citizens."

I would like to enter that letter into the record.

Chairman GUTIERREZ. Without objection, it is so ordered.

Mr. BACHUS. Thank you. Make no mistake, illegal Internet gambling ruins lives and tears families apart. Study after study has shown that gambling, Internet gambling, is a scourge on our society that leads to addiction, bankruptcy, divorce, crime, and moral decline.

Illegal Internet gambling intensifies the devastation wrought by gambling by bringing the casino into the home. According to a recent study, 74 percent of those who had used the Internet to gamble have become addicted to gambling, and many of these gambling addicts have turned to crime to support their habit. Research also indicates that in 2006 alone, nearly 10 percent of college students gambled online.

Indeed, at our committee's last hearing on this subject, we heard testimony from Greg Hogan, whose son was once the president of his class at Lehigh University but now sits in a Pennsylvania prison after committing bank robbery in a desperate attempt to erase his Internet gambling debts. We also heard testimony from the NCAA about several college athletes who had turned to Internet gambling after betting on football games, some of which they were involved in.

But the harm that illegal Internet gambling inflicts on our society extends beyond the personal tragedies of the Hogans or other American families like them. Illegal Internet gambling also jeopardizes the security of our Nation. The FBI and the Department of Justice both testified before this committee that Internet gambling serves as a vehicle to launder the proceeds of illegal activities,

helps fund drug trafficking, facilitates tax evasion, and perhaps most frightening of all, can be used to finance terrorism.

To address these harms, this Congress enacted the Unlawful Internet Gambling Enforcement Act of 2006. Since its enactment, illegal Internet gambling among college-age youth has declined from 5.8 percent in 2006 to 1.5 percent in 2007. This is a significant achievement. But any success the Act has had in decreasing the rate of illegal Internet gambling would be short-lived if criminals believe that the Act will not be enforced. That is why it is critical that the proposed regulations that are the subject of today's hearing be done right and implemented without further delay.

In its current form, the regulations that Treasury and the Federal Reserve have proposed require U.S. financial institutions participating in designated payment systems to prevent transactions in connection with unlawful Internet gambling. This requirement is an essential—could I have unanimous consent to have one more minute?

Chairman GUTIERREZ. Without objection, it is so ordered.

Mr. BACHUS. Thank you. This requirement is an essential first step, but it is worth emphasizing that all forms of payment should be covered, because a single exemption leaves the law suspect to evasion. The proposed rules provide exemptions for U.S. financial institutions that participate in designated payment systems if the regulators jointly determine that it is not reasonably practical for these firms to prevent illegal transactions. This exemption ensures that the financial institutions are not burdened with implementing impossible or impractical standards, but the rules should make clear that exempted financial institutions that do become aware of restricted transactions should be required to block them.

Thank you again, Mr. Chairman, for holding these hearings and for our witnesses.

Chairman GUTIERREZ. You are very welcome, Mr. Bachus. I recognize the chairman of the full committee, Mr. Barney Frank.

The CHAIRMAN. Mr. Chairman, the ranking member is correct in saying that I opposed this bill and would like to see it repealed—not the bill, the underlying Act that these regulations implement. I think it is an intrusion into personal liberty motivated by the fact that a majority of members dislike the purposes to which the liberty is being put. But that does not mean there is no separate issue regarding regulation. I would urge Members on all sides to contemplate the arguments that are being made.

First, as to the attorneys general, let me say that we thought we had preserved States' rights in the bill. We have written to them and told them we would be glad, those of us who sponsored the underlying repeal bill, to make clear that the States have that right. But beyond that, what they are objecting to is something that I thought many members of this committee supported, namely, uniform rules on the Internet. So understand the principle that is involved here and the precedent that is being set, namely, if Members of Congress have a moral objection, we can intrude on the freedom of the Internet and we can tell people what they can and cannot do on the Internet.

Now I had previously understood that to be something that Members didn't support, and which States have said, well, we want

to be able to collect sales taxes. I have been all for letting the States collect sales taxes through the Internet. I cannot see what the intellectual and principal difference is between saying that the States are wholly in charge of whether or not individuals choose to gamble, but they have no say about whether or not the sales tax can be levied. So you are setting the precedent of a federalization of the Internet based on the moral views of Members of Congress.

Now I understand that some people abuse gambling. Some people abuse video games. Some people abuse alcohol. Some people abuse a lot of things. The notion that a society prohibits most people from doing something because a small percentage abuse it, I had never thought to be the guiding principle.

But then we get to the question of the regulations, and here the argument appears to be that given the importance of the underlying objective, let's not pay any attention to whether the regulations are burdensome or not. Again, that is not a position that I thought many of my conservative friends adhered to. What we are being told in effect is, well, forget about whether or not the regulations are burdensome or inefficient. Virtually every sector of the economy affected by these regulations has complained about them.

The Federal Reserve in testimony, and I appreciate their candor, says: "This is a challenging task. The ability of the final rule to achieve a substantial further reduction is uncertain. Our objective is to craft a rule to implement the Act as effectively as possible in a manner that does not have a substantial adverse effect on the efficiency of the nation's payment system."

This didn't come from gamblers. This came from the Federal Reserve. And are we to say that, given the overriding importance of the moral objection many Members have to gambling, we will therefore go forward with regulations no matter how much they might intrude on the efficiency of the system? Well, that is not a great precedent to set. It does seem to me that it is important to say there is the objective and then there is a separate question as to the regulations.

Now I am of the view, and there are two separate questions here, that the manner in which the Congress has chosen to outlaw gambling is the wrong one. That is, we have an objection to gambling, and we have enlisted the payment system and the banks of America to be our anti-gambling cops, to the detriment, I believe, of their ability to carry on their important financial intermediation function. Maybe it was to try and get it into this committee. I know the former chairman, the gentleman from Iowa, my predecessor, who is ranking member, the gentleman from New York, they really didn't like gambling, and they wanted our committee to be the one that drove the stake through its heart. But I think that was an error.

I think it was—and, again, I am not in favor of banning gambling. I did not come here to tell other people what to do with their leisure time. But even those of you who do feel confident in your ability to supervise the leisure activities of other adults ought to find a way to do it directly without drafting the financial system of this country and putting it in the service of your moral objections. And I believe that the difficulties we are seeing in enforcing the regulation are not due to any shortcomings on the part of those

doing it. I think the Federal Reserve and the Treasury are doing their best. We just gave them the wrong job.

Again, if you want to get rid of gambling, find some other way to do it, but don't impose—and, look, the Federal Reserve is not given to hyperbole. When the official statement of the Federal Reserve System is we are trying "to craft a rule to implement the Act as effectively as possible in a manner that does not have a substantial adverse effect on the efficiency of their payment system," that means that this could very well be an adverse effect. They don't deal with chimera.

So what we are apparently being told is, well, a little adverse effect on the payment system is worth it because we will feel so much better when we stop people from gambling. I do disagree with the underlying objective of the Act. But even those who agree with it ought to be willing to say, you know what, let's find a different way to enforce it. Let's not burden the important payment system by doing it this way.

Chairman GUTIERREZ. All time has expired on our side. I have a list handed to me by the staff of the minority, and without objection, I will follow this: Representative Hensarling of Texas for 2 minutes; 1 minute to Representative Davis of Kentucky; and I would ask for unanimous consent of the members of the subcommittee to allow Representative King 1 minute. Without objection, that—

The CHAIRMAN. Reserving the right to object, you never know when you are going to want something from the Governor of New York, so I won't object.

[Laughter]

Mr. BACHUS. You mean if I object, he doesn't get—

Chairman GUTIERREZ. That's true, Mr.—

Mr. BACHUS. Well, I guess I don't object.

Chairman GUTIERREZ. Okay. Representative Hensarling for 2 minutes.

Mr. HENSARLING. Thank you, Mr. Chairman. I doubt I will need the entire 2 minutes. Clearly, many interesting and important issues are presented by the Unlawful Internet Gambling Enforcement Act, but I just want to make one brief point. And that is, if Congress passes a law that the Federal Government itself finds difficult or impossible to enforce, and turns to private enterprise to essentially enforce that law for them, then we must have clarity in our regulatory framework. We need black and we need white; we don't need shades of gray.

I think that a lot of very important issues have been raised during the comment period on these regulations. And having been a small businessperson before I came to Congress and not being able in my own small business to afford an army of attorneys, I know what happens is, the businesses tend to get risk-adverse. When you're dealing in shades of gray, you get very risk-adverse, and I do want to make sure that as Congress tries to single in on one type of criminal behavior that lawful commerce is not unduly burdened. I'm not sure that these proposed regulations have met that mark, and so I would hope that at the end of the day, we could at least have regulatory certainty for all the legitimate businesses out there in this space if we're expecting them to essentially do the

job of law enforcement that the Federal Government finds difficult or impossible to do.

With that, Mr. Chairman, I yield back.

Chairman GUTIERREZ. The gentlewoman from California, Maxine Waters, is recognized for 3 minutes.

Ms. WATERS. Thank you so much, Mr. Chairman. I'm looking forward to today's testimony on the proposed regulations to implement a bill that was passed out of both the Financial Services and Judiciary Committees last session, the Unlawful Internet Gambling Enforcement Act. By addressing only Internet gambling that was already unlawful, the legislation passed last session was a bipartisan effort to enhance enforcement by cutting off the flow of revenue to illegal enterprises. The bill prohibited the receipt of checks, credit cards charges, electronic funds transfers, or similar transactions by such unlawful businesses.

I served on this committee and the Judiciary Committee and I voted in each committee to report the bill to the House after vigorous and passionate debate. When the measure was considered on the Floor as a stand-alone bill, I voted for it. I also voted for it after it was added to the Safe Ports Conference Report, which was ultimately signed into law. Now some have noted that the bill passed in the dead of night, and it's true that it was very late at night, but the final vote was 409 in favor, and only 2 votes against.

Today I'm not so sure how I would vote on this bill. I have certainly been challenged by my friend, Barney Frank, and he pushes a particular button with me when he talks about legislating morals or vices without infringing on fundamental rights. Supporters of the bill stressed that the compromise language that emerged from the two committees was the product of 10 years of hard work by a very unusual alliance of organizations and competing interests, from religious organizations like the United Methodist Church, to professional sports organizations like the National Football League.

One of the reasons I am really reconsidering my vote on this legislation is because some of those organizations that are in such strong support of the bill are organizations that I have reviewed very carefully, and I'm wondering about some of their decisions in the way that they manage their own business, and whether or not there are some questions of morality in the way that they treat some of those in their organization.

So, again, I'm very seldom in a position where I change my vote, but this may be one of those times. But let's see what today's testimony will bring. I yield back the balance of my time.

Chairman GUTIERREZ. I thank the gentlewoman. I recognize Congressman King of New York for 1 minute.

Mr. KING. Thank you, Mr. Chairman. Thank you for extending the courtesy to me to sit here today, and I thank Ranking Member Bachus for withdrawing his objection to my appearance.

Very seriously, like Chairman Frank, I am a co-sponsor of H.R. 2046, because I believe it has protections built into it which would address the concerns that Congressman Bachus has raised, for the purpose of today's hearing is on the regulations. My concern is the unintended consequences that can and often do result when we ask financial regulators to in effect interpret laws for Congress and enforce morality for Congress.

I think if we're talking about sports gambling, that's one thing. But to be asking regulators to define what is unlawful conduct, what is unlawful gambling, to me really runs a severe risk of going too far. And this is an issue I think which brings people from all sides together. Just the other day I received a letter—in fact, just today, from Grover Norquist, president of Americans for Tax Reform, where he expresses severe concerns about the implications of this rule in terms of personal freedom, personal privacy, and regulatory burden on the banking industry and international trade.

So I think going ahead with these regulations poses real dangers. I don't know why we just don't confine it to sports gambling and leave it at that for now. And I would ask, Mr. Chairman, for unanimous consent to place in the hearing record a statement for the hearing by one of our on-leave members of the committee, Representative Sessions from Texas, with a letter from Mr. Sessions and other members, the Secretary of the Treasury and Chairman of the Federal Reserve.

Again, I thank you for allowing me to be here today. I'm a member of the full committee but not the subcommittee. I look forward to the testimony, and, again, I just want to express my concern that these regulations, as they go forward, could really have unintended consequences that all of us would rue in the future, and I ask unanimous consent to insert the statement in the record. I yield back.

Chairman GUTIERREZ. Without objection, it is so ordered. Representative Davis of Kentucky for 1 minute.

Mr. DAVIS. I would like to thank you, Mr. Chairman, for allowing me to participate briefly and also Ranking Member Bachus. What I would like to do is ask unanimous consent to place in the hearing record comments submitted by the National Thoroughbred Racing Association, a critical part of the Commonwealth of Kentucky's economy, for some perspective related to the discussions that we are going to be having today, and I yield back the balance of my time.

Thank you.

Chairman GUTIERREZ. We are pleased to have with us on the first witness panel representatives from the Board of Governors of the Federal Reserve System and the U.S. Treasury Department. Testifying on behalf of the Federal Reserve Board is Louise L. Roseman. Ms. Roseman is Director of the Board's Division of Reserve Bank Operations and Payment Systems. Appearing on behalf of the Treasury Department is Deputy Assistant Secretary Valerie Abend. Ms. Abend is the Deputy Assistant Secretary for Critical Infrastructure Protection and Compliance Policy.

Director Roseman, you may proceed.

STATEMENT OF LOUISE L. ROSEMAN, DIRECTOR, DIVISION OF RESERVE BANK OPERATIONS AND PAYMENT SYSTEMS, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Ms. ROSEMAN. Chairman Frank, Chairman Gutierrez, Ranking Member Bachus, and members of the subcommittee, I am pleased to appear before you today to discuss our efforts to implement the Unlawful Internet Gambling Enforcement Act.

As you are aware, the Act requires designated payment systems to establish reasonable policies and procedures to prevent transactions to fund unlawful Internet gambling activity. Congress recognized, however, that it may be difficult for certain payment systems to prevent restricted transactions and required the agencies to exempt payment systems from the rule's requirements if it was not reasonably practical for them to comply.

The commenters to the proposed rule highlighted a number of the limitations in using the payment system to combat unlawful Internet gambling activity. The most prominent concern, as was discussed here this morning, was the lack of clarity as to what forms of Internet gambling are unlawful, and therefore what payments need to be blocked. The proposed rule, like the Act itself, doesn't spell out which gambling activities are unlawful, but rather relies on the underlying substantive Federal and State laws. Unfortunately, the activities permissible under these laws are not well settled, and they are subject to varying interpretations.

Congress itself recognized this fact when it excluded from the definition of unlawful Internet gambling activity allowed under the Interstate Horse Racing Act, but included a sense of Congress that the horse racing exclusion is not intended to resolve any existing disagreements over how to interpret the relationship between the Interstate Horse Racing Act and other Federal statutes. Commenters stressed that uncertainty such as this would make compliance with the rule very difficult. We are considering modifications to the rule that would provide greater certainty to payment system participants, but our ability to provide complete certainty is limited given the ambiguities of the underlying statutes.

The second challenge, as our proposed rule acknowledged, is that most payment systems don't have the functional capability to identify and block payments made for specific purposes or initiated in specific ways, such as over the Internet. In our view, the institution that has the customer relationship with the Internet gambling business is in the best position to determine the nature of that customer's business and whether the customer is likely to receive restricted transactions for credit to its account. Therefore, with respect to domestic transactions, the proposed rule exempted all participants in the check, ACH, and wire transfer systems except for the participant that has that customer relationship.

Bank commenters generally indicated that they could perform due diligence on their business accountholders at the time of account opening, assuming they could readily determine which forms of Internet gambling activity are unlawful. Large banks in particular believed that it would be quite burdensome, however, to determine which of their many existing business customers engage in Internet gambling because they have not retained records in a manner to enable them to identify customers by line of business.

We recognize, however, that most Internet gambling businesses are based outside the United States and generally have offshore banking relationships. This poses additional practical limitation on the ability of the U.S. payment system to block restricted transactions, particularly if made by check, ACH, or wire transfer. In such cases, we proposed placing the compliance responsibility on

the U.S. payment system participants that send transactions to or receive transactions from foreign institutions.

Commenters stated that measures U.S. banks could take to prevent foreign banks from sending restricted transactions would likely be unworkable. Foreign banks generally have legal obligations in their own countries to prevent financial crimes such as money laundering or terrorist financing. However, foreign banks have little incentive to identify or prevent Internet gambling activity, which is generally permissible outside the United States. There may be few options for dealing with restricted transactions through international banking relationships without significantly disrupting cross-border payment flows.

In closing, I would like to note that funding unlawful Internet gambling activity through the U.S. payment system has become more difficult in recent years, due in large part to steps card issuers and money transmitters have already taken on their own initiative to prevent these transactions. The extent to which the final rule can substantially further restrict the use of the U.S. payment system for unlawful Internet gambling is uncertain.

Together with the Treasury, we are carefully considering all comments received and assessing what changes we should make to the rule to implement the Act as effectively as possible without having a substantial adverse effect on the Nation's payment system.

I would welcome any questions you may have.

Thank you.

[The prepared statement of Ms. Roseman can be found on page 95 of the appendix.]

Chairman GUTIERREZ. I thank you very much.

Ms. Abend, please.

STATEMENT OF VALERIE ABEND, DEPUTY ASSISTANT SECRETARY FOR CRITICAL INFRASTRUCTURE PROTECTION AND COMPLIANCE POLICY, U.S. DEPARTMENT OF THE TREASURY

Ms. ABEND. Chairman Frank, Chairman Gutierrez, Ranking Member Bachus, and members of the subcommittee, it is my privilege to appear before you today to discuss the Unlawful Internet Gambling Enforcement Act of 2006.

The Act was fashioned to require payment systems to interdict the flow of funds from gamblers to businesses providing unlawful Internet gambling services. To accomplish this, the Act requires the Treasury Department and the Federal Reserve Board, in consultation with the Justice Department, to jointly prescribe regulations requiring participants in designated payment systems to establish policies and procedures that are reasonably designed to prevent or prohibit such funding flows. It also requires that payment systems or portions of payment systems be exempted in situations in which it would not be reasonably practical for payment systems to prevent or prohibit unlawful Internet gambling transactions.

On October 4, 2007, the Treasury Department and the Federal Reserve Board, after consultation with the Justice Department, published a Notice of Proposed Rulemaking seeking public comment. Our goal when writing this proposed rule was to faithfully

adhere to the mandate set forth by Congress in the Act. The comment period closed December 12, 2007.

We received more than 200 comments from a diverse group of interests, including entities potentially subject to the proposed regulations, individuals and groups supportive of Internet gambling, individuals and groups opposed to Internet gambling, and others.

We are currently reviewing each comment closely, and analyzing the issues presented. Many comments present more than a single issue, and certain issues require additional research.

Some of the comments address the meaning of statutory definitions provided by Congress, the applicability requirements to portions of designated payment systems, and the impacts this proposed regulation could have in the event it were to be finalized as proposed.

Crafting such a joint rulemaking requires extensive coordination. We have been impressed with the quality of the comments provided and with the effort and expertise employed in the development of many of those comments.

An overarching goal for our efforts has been to closely adhere to the statutory instructions provided to us by Congress. The Act requires designation of payment systems that could be used in connection with unlawful Internet gambling. Such a designation makes the payment system and financial providers participating in the system subject to the requirements of the regulations. The proposed rule designated the following five payment systems:

(1) Automated Clearing House Systems;
(2) Card Systems;
(3) Check Collection Systems;
(4) Money Transmitting Businesses; and
(5) Wire transfer Systems.

The proposed rule partially exempts certain participants within some of the designated payment systems from having to establish reasonably designed policies and procedures. The Treasury and the Federal Reserve Board determined that this was the most appropriate way to implement the Act while retaining fidelity to the intent of Congress.

Under the proposed rule, the gambling business's bank would not be exempted because it could, through reasonable due diligence, ascertain the nature of its customer's business and ensure that the customer relationship is not used to receive unlawful Internet gambling transactions. The proposed exemptions generally extend to the gambler's bank.

The Act further requires providing nonexclusive examples of policies and procedures which would be deemed reasonably designed to prevent or prohibit unlawful Internet gambling transactions. As a result, this proposed rule contains a safe harbor provision as mandated by the Act that includes for each designated payment system nonexclusive examples of reasonably designed policies and procedures.

The Treasury, working closely and collaboratively with our colleagues at the Federal Reserve Board, is making progress in reaching our statutory mandate to promulgate a final rule that strictly adheres to the Act. No final decisions have been made regarding any aspect of the final rule or the comments provided, and we are

still considering all aspects of the proposed rule. When we publish a final rule, we will of course provide analysis of the comments received and the reasons for any decisions. We are committed to giving fair consideration to all relevant comments as we are working toward promulgation of a final rule. We have benefitted from the knowledge and the efforts of our colleagues at the Federal Reserve Board and the Justice Department as we have proceeded in our consideration and analysis.

Thank you, and I would be happy to answer any of your questions.

[The prepared statement of Ms. Abend can be found on page 43 of the appendix.]

Chairman GUTIERREZ. Thank you, Ms. Abend. I would like to ask unanimous consent that the following items be inserted into the record: the statement from Professor H.H. Weiler, NYU Law School; a letter from Jim Tozzi, Center for Regulatory Effectiveness; a statement from Marsha Sullivan, Consumer Bankers Association; a letter from Chamber of Commerce; a letter from Americans for Tax Reform; a Comment Letter, Office of Advocacy, Small Business Administration; a statement from Rick Smith, the UC Group; the NAFCU letter; and the Bank of America statement of Gregory Baer.

Without objection, it is so ordered.

I thank the witnesses. First, I would like to ask the Federal Reserve Board, the proposed regulations refer to various actions that must be taken when a covered payment system "becomes aware" that a customer is engaging in restricted transactions.

Numerous commenters raised concerns with this standard, and how difficult it would be to apply. What exactly does the term "becomes aware" in the proposed regulations mean?

Ms. ROSEMAN. Well, that is something, as you mentioned, that we did get a number of comments on. Commenters said that it would be clearer if the regulation had a standard such as having actual knowledge rather than "becomes aware," because of the ambiguity on how to apply that other standard. It is something that we are looking at as we develop the final regulation.

You had indicated that if an institution "becomes aware" there are certain required actions they must take. The proposed regulation provided examples of different actions that could be taken, but we said explicitly that these are examples of reasonable policies and procedures, but payment system participants would be able to develop alternate policies and procedures that may also be deemed reasonable.

Chairman GUTIERREZ. Let me ask Ms. Abend, the proposed regulations require that when the payment system, again, becomes aware that the customers receive restricted transactions, it must take certain actions which may include closing the customer's account or severing the relationship with the customer. There is no further guidance on how many transactions it would take for such drastic action to occur. But as drafted, it appears that it could be as little as two. Are there size or volume thresholds for severing a relationship with a customer? If an account is closed, must it remained closed? How will disputes be resolved if there is a question as to the legality of the transaction or the action of the agency?

Ms. ABEND. Well, Mr. Chairman, I would echo what my colleague from the Federal Board has said, which is, first and foremost, we did receive these comments about what does "become aware" mean and how should we develop a standard, if any, that would apply to "becomes aware." We're still considering what to do with respect to that comment.

We have not come to any sort of final determination of whether that is a volume-driven type of transaction or if someone were to come and notify them if that would by law enforcement or a Federal financial regulator. And so I think we're still taking it under consideration about how we would answer that comment.

Chairman GUTIERREZ. Well, it just appears to me that since several months have passed and each of you and the group—I mean, both the Federal Reserve and Treasury, have excellent people working there, that we would tread carefully as we pursue these issues, because many people made the comment, as both of you responded. And it seems to me to be a valid area. Just what is it you are going to do, and the degree of certainty with which you act and which banks and financial institutions act are going to be critical to not somehow violating the rights of others as we try to police gambling in America.

I have actually not an underlying problem with trying to do it, although it is always difficult when you buy lottery tickets, and since I am getting to be 54 years old, I get all these prospectus all the time and they all tell me, be cautious. You have a lot of risk. So I'm getting these prospectus all the time from mutual funds and for stocks and bonds. And I think they're asking me to gamble each and every time, because they're certainly—because of the Federal Government and regulations we have taken, there are many warnings. And so if because of those warnings, I don't do it. I don't know if we can do the same thing with a lotto ticket or somebody betting on their favorite college team.

So, I would just say we look forward to having you back as the regulations become more finalized and formalized, because I think it's going to be very, very critical that we make sure that we do it in a very careful minded way.

Before I go to Mr. Bachus, I'm going to ask unanimous consent that Mr. Davis, who has already participated, be allowed to ask questions. And now I have the list from the minority, beginning with Mr. Bachus. You are recognized for 5 minutes.

Mr. BACHUS. Thank you. I appreciate our witnesses testifying. I would like to hand you at this time a letter from the NFL, Major League Baseball, the NBA, the National Hockey League, and the NCAA. And this letter, I think you have had for about 9 months. Have you gone over this letter pretty carefully?

Ms. ROSEMAN. Yes. We have been looking at all the comments we have received. They have raised issues on many aspects of the regulation. The payment system, frankly, isn't well designed to be able to identify unlawful Internet gambling activity. And that is posing a number of challenges to us, along with the uncertainty with respect to what forms of Internet gambling should be proscribed by the regulation.

Mr. BACHUS. You know, they point out some interesting things; they are telling us that, for instance, you all say you can assemble a list of bad actors, and that is impractical. Is that—

Ms. ROSEMAN. In the proposed regulation, we didn't explicitly propose a list, but in the supplementary information accompanying the proposed rule, we did discuss the pros and cons of having such a list, talking about the challenges of developing a list, and we asked commenters a number of questions with respect to the desirability of having such a list in the final rule.

Mr. BACHUS. You know, all of these lists would be of illegal gambling operations, many of them offshore. What struck me is that our staff did just a cursory study where in at least 5, but I think as many as 17 cases, you have done that. I guess the more recent are the cross-border flow of monetary instruments, legislation on that. You didn't have a problem with that. The currency transaction reporting requirements, you assembled it for that. The Bank Secrecy Act, you do it under that. Anti-money laundering statutes, you do it under that. You do it under the terrorist financing, and there is not a problem there.

Also, you said that it is not practical for ACH, wire transfer, and check system participants to block restricted transactions except for those by entities that either have a direct relationship with the Internet gambling site or certain international payments. But in fact, in all these statutes, and in about 12 others, you do that. Do you see what I'm saying? So, I mean, I'm somewhat mystified as to why—do you understand what I'm saying? I'm just saying that you all do it. There are so many cases where you require an institution to do it. They do it. They said they—in fact, and another thing, Representative Paul Gillmor is dead now, but he pointed out that the small banks said they could do this but some of our largest, most sophisticated financial institutions said they couldn't. That strikes me as incredibly odd. I'm sorry.

Ms. ROSEMAN. In looking at the list idea, many commenters used as analogy the OFAC list. I think the one thing that really distinguishes the list here from the OFAC list is that OFAC lists particular entities with whom you shouldn't have transactions. In this case—

Mr. BACHUS. And the NCAA has identified 900 of those.

Ms. ROSEMAN. Yes. But in this case, it is restricted activity, not restricted parties. So even gambling operations may have a combination of payment transactions that would be restricted under this law and others that would not be.

Mr. BACHUS. All right. Let me dispute that. We are talking about illegal Internet gambling enterprises that are not licensed to do business in the United States. Now how could they possibly—they are illegal. They are criminal enterprises. They are not authorized to do business in the United States or transact business.

Ms. ROSEMAN. The companies that have these businesses may also have other commercial transactions that they conduct that would be totally unrelated to gambling.

Mr. BACHUS. Well, I understand that, but—

Chairman GUTIERREZ. The gentleman's time has expired.

Mr. BACHUS. But if they are doing an illegal enterprise, you—and other enterprises if they are doing something illegal, they may

do something legal, but you block them in all these other statutes, because—in fact, you block them because they do that.

Chairman GUTIERREZ. Ms. Roseman, please answer the gentleman's question, and then we will proceed.

Ms. ROSEMAN. Bottom line, we did get a lot of comments about the list. It is something that we are looking at as we develop the final rule. As Ms. Abend mentioned, we haven't come to any final decisions, but we certainly understand the interests of both the financial industry and of the professional sports leagues, to have certainty with respect to what is lawful and what is unlawful.

Mr. BACHUS. Yes. And I—

Ms. ROSEMAN. But we understand the objective.

Mr. BACHUS. I guess my point is, saying that you can't do something you're doing in 17 other statutes is sort of unusual.

Chairman GUTIERREZ. The gentleman's time has expired. Chairman Frank.

The CHAIRMAN. Well, to begin, we are prepared in the language to exempt the sports leagues. We already allow them to. But as I understand it, what they are apparently telling you is that they, as I read their letter, that the gentleman—they want these regulations as proposed adopted, and what they are saying is, because there might be some problem with their business, even though they could be exempted, they are insisting that regulations be adopted that all of those on whom they would fall would find very burdensome. Their total lack of concern for the payment system, for the legitimate arguments raised by the others, is troubling.

But I'm particularly intrigued by the question of horse racing. And I admit that I am not a Biblical scholar, and I often am unable to follow some of the distinctions that Biblical scholars make. The one I have been struggling with is in all of the moral teachings about gambling—you know, I have this problem with regard, for instance, to conservative economics, free market, free enterprise—I have not yet found the footnote that says except agriculture, that many of my conservative colleagues believe deeply.

Similarly, I can't find the exemption for horse racing in all of the anti-gambling morality, or in the statistics on people being addicted. But as I understand it, we did get a letter from the gentleman from Kentucky urging that you make clear that we are exempting horse racing, and I thought betting on a horse was gambling. Apparently, betting on a horse is not gambling. Perhaps it is animal husbandry, I don't know.

But let me ask you, because one of the problems we have is uncertainty. And there is really a rather extraordinary provision in this law that says nothing in this bill—this is the underlying law the gentleman from Alabama sponsored—there is a provision that says nothing in this law will resolve the uncertainty as to whether or not it covers horse racing. Really, a rather bizarre piece of legislation. Congress says Congress cannot make up its mind about the conflict. But let me ask you, with regard to people who gamble through the Internet on horse racing, in States where that is not legal, is that banned or not banned, according to the regulation? Let me ask each of you.

Ms. ROSEMAN. Well, in our consultations with the Department of Justice, their belief is that it is illegal in all States irrespective of whether the individual State has banned it or not.

The CHAIRMAN. But does the regulation say that?

Ms. ROSEMAN. The proposed regulation did not say that because we did not go down the road of trying to resolve the—

The CHAIRMAN. Well, say I'm a bank, and I get this processing request for someone who made a bet on a horse race. Do I accept it or do I reject it? According to the regulation.

Ms. ROSEMAN. That was the biggest comment we received.

The CHAIRMAN. Well, I understand that, but I didn't ask you how many comments you received. What do I do? I'm a nice little bank here, and I don't want to, you know, I say, well, look, I—you know, who am I to counteract the great morality of that wonderful Congress that tells everybody how to live a good life? And how do I interfere? So now somebody wants to make a bet on a horse. Do I allow that bet to be paid, or do I not? You have made the regulations.

Mr. BACHUS. I would allow you to do it.

The CHAIRMAN. Well, I didn't yield.

Mr. BACHUS. I would let you bet.

The CHAIRMAN. I didn't yield to the gentleman, and if the gentleman wants to make a clarification, he ought to do it in the law, this law that he helped to pass, that says we don't know. I guess they're against gambling except that the bank has to gamble. But I do want to ask the question. Under the regulations as proposed—they may be amended—I am a financial institution. Do I or do I not process that payment for a bet on a horse?

Ms. ROSEMAN. I would assume that most institutions would not process—

The CHAIRMAN. No, no. I'm not asking you to assume what they would do. You're the regulator. And I understand you didn't write this silly business, and don't take it personally, but you have this responsibility. When the lawyer calls you and says, okay, counsel to the Fed, counsel to the Treasury, I have a very law-abiding client here. What should she do? Should she process this payment? Or if she processes the payment, is she violating the law? What is the answer?

Ms. ROSEMAN. Unfortunately, the proposed regulation was silent on that issue, and I think that is something we are going to need to look at for the final regulation.

The CHAIRMAN. So the answer is to gamble on it?

Ms. ROSEMAN. That is essentially what—

The CHAIRMAN. And our friends at the NFL and the AFL, etc., have said—no, the NFL and the major leagues—you go ahead and do it. So we are telling the entire payments—the entire financial structure of America that whether or not—and I would guess that betting on horses is a substantial part of gambling—I think that is the greatest abdication of responsibility that I can think of for Congress to foist that set of choices and ambiguities on the system.

Thank you, Mr. Chairman.

Chairman GUTIERREZ. Thank you. Mr. Marchant is recognized for 5 minutes.

Mr. MARCHANT. Thank you, Mr. Chairman. Ms. Roseman, I have heard you say that these are not the final rules and that all of the comments will be taken into consideration. Will the final rule define unlawful Internet gambling?

Ms. ROSEMAN. I can't say at this point exactly what is going to be in the final rule. The challenge we have is interpreting something—particularly Federal laws where Congress itself isn't sure what they mean, and then trying to figure out ourselves how to interpret them. That is something we are really struggling with at the moment.

Mr. MARCHANT. Is it your feeling that Federal law is clear on what unlawful Internet gambling is?

Ms. ROSEMAN. No, I don't think it is. I think that there are different Federal laws that interact with each other, and that is creating the challenge.

Mr. MARCHANT. But there are—States are more clear on their laws as far as what—

Ms. ROSEMAN. States with respect to truly intrastate activity. What we're talking about with the horse racing would be interstate.

Mr. MARCHANT. If the regulators cannot, and it doesn't sound like they're optimistic that they can define what unlawful Internet gambling is, how will my bank in my hometown know what it is when they see that transaction?

Ms. ROSEMAN. I suspect that they would take a conservative approach and assume that all Internet gambling is unlawful.

Mr. MARCHANT. What if the transaction is wrapped in the appearance of another type of transaction? What if you are placing your bet at Joe's T-Shirt Shop in the invoice and all the transaction reflects is a purchase and a transaction with Joe's T-Shirt Shop?

Ms. ROSEMAN. In that case, payment system participants would have no way of knowing that the transaction actually related to unlawful Internet gambling and would likely process the transaction.

Mr. MARCHANT. And there would be no penalty in that instance for that financial institution?

Ms. ROSEMAN. I would think not. They would have no way to have flagged that transaction as having been unlawful.

Mr. MARCHANT. So isn't it likely that in response to—and I would like for you to contemplate this in the final rules—isn't it likely that as nimble as the Internet is, and as resourceful as the Internet gambling industry is, that they will adopt a mechanism to make no transaction appear to look like an Internet gambling transaction?

Ms. ROSEMAN. I think there is this risk, depending on how the rule works. In the proposed rule, there was some responsibility placed on the bank that held that company's banking relationship. So if the bank that had the business relationship with Joe's T-Shirt Shop started seeing a pattern of transactions that seem unusual for that business, it may want to probe further about what is happening. Or if a bank that signed that business up accepts credit cards, and it used a regular retailer merchant category code rather than the gambling merchant category code, if the bank was aware of what the true activity was, it would have a responsibility to do something about it.

Mr. MARCHANT. Yes. I just, a month or so ago, had my credit card number used, and I discovered within about 30 days that there are hundreds of different mechanisms and false companies and companies that sell no products, companies that have nothing—no purpose whatsoever except to process stolen credit card numbers through, and of course my credit card company was very good about being able to recognize that after the fact. But it was from me prompting them and calling them and saying, you know, I don't buy—I really didn't buy anything at Bloomin' Candles in Minnesota. But if you don't have the proactivity on the part of the customer and you are solely dealing with the Internet provider, of the Internet, then I would like for you to contemplate this part of it in your final rules.

Chairman GUTIERREZ. The gentleman's time has expired. Mr. Clay is recognized for 5 minutes.

Mr. CLAY. Thank you, Mr. Chairman. Let me start with Ms. Abend. The Administration and some of my colleagues have been adamant that we cannot overburden the banking sector with laws and regulations governing community lending, governing unscrupulous lending practices and other policies designed to help and protect people. Does it not seem incongruous that against the backdrop of the subprime crisis and all of the other challenges faced by the banking industry that we would impose this additional burden on the banks?

Ms. ABEND. Well, Congressman, you know, certainly the current market conditions are the number one priority facing the Secretary and certainly is where our attention is being spent, but with regard to this particular proposed rule, we are carrying forth, as we are required by statute, to implement proposed regulations and ultimately a final regulation adhering very closely to the statute that was provided to us. So we're just following what we had to do as required by mandate.

Mr. CLAY. Well, let me ask you, how realistic is it that authorities can actually police Internet gambling, that they can actually enforce this law, that they could stop the scourge of Internet gambling? How realistic that we are going to be effective in that process of stopping Internet gambling?

Ms. ABEND. Well, I think we certainly proposed a rule that we thought very much adhered to what the sense and the intent of Congress was to try and stop the illegal activity and the illegal transactions. I'm sure that there's no regulation today on anything that is 100 percent possible at blocking all of the illegal activity, but it is, we hope, our final rule will be a strong deterrent.

Mr. CLAY. Well, but I can see us getting into a lot of discretionary decisions, a lot of judgment calls on the part of the regulators and the banks, especially when you look at this confusing chapter in the law about horse racing. I'm not even sure does it exempt horse racing, does it not?

And then we have requests from the major sports leagues who also want to be exempted, but they didn't include the fact that they are already conducting gambling over the Internet through Sportsbooks, through Las Vegas casinos and others. Sportsbooks take bets on all kinds of professional games, and college games. So how do we—how will we separate this and actually enforce it?

Ms. ABEND. Well, Congressman, I think as you have heard from my colleague from the Federal Reserve Board, this issue of clarity, which we received so many comments about on all sides of the issue, some proposing that we clarify what is legal or illegal gambling, others proposing if we produced a list, that is something that we, as my colleague, Louise, has said, from the Federal Reserve Board, are struggling with and trying to figure out what if anything we can do.

I certainly would also mention that in our consideration, we are, as required by the statute, consulting with the Department of Justice, who truly are, from a Federal standpoint, more of the experts when it comes to the statutory Federal definitions of legal and illegal gambling.

Mr. CLAY. Okay. Ms. Roseman, any comments on how we can effectively enforce the statute?

Ms. ROSEMAN. I think it is going to be very difficult to enforce. The implementing regulations will not be ironclad. It will be very difficult to totally shut off the payment system for use in unlawful Internet gambling. As was mentioned earlier, companies could disguise the purpose of the transaction. In many payment systems, the purpose isn't even included in the payment that flows through the financial industry to begin with.

Mr. CLAY. So the law doesn't have teeth to begin with. It's just a statement, more of a statement from this body than anything else?

Ms. ROSEMAN. I think the law is relying on the payment system—

Mr. CLAY. I'm going to stop you there and yield the rest of my time—

The CHAIRMAN. Let me just ask, on the—if I could briefly, on the question of confusing. I have been informed that the 5th Circuit in 2002 ruled that horse race gambling was legal. So in the interpretation, would it make any difference if I were a bank in the 5th Circuit or elsewhere? Now I know the Justice Department doesn't agree with the Fifth Circuit.

Mr. BACHUS. Point of order.

Chairman GUTIERREZ. The gentleman will state his point of order.

Mr. BACHUS. I have no problem with the chairman asking this question, but I would also ask for equal time.

The CHAIRMAN. Well, that wouldn't be a point of order, I guess. The gentleman didn't object to my asking the question as long as he didn't think it was a tough question, so I'll withdraw it and ask it later.

Chairman GUTIERREZ. Mr. King, you are recognized for 5 minutes.

Mr. KING. Thank you, Mr. Chairman. Thirty years ago I was general counsel to a government-run off-track betting corporation in New York, and we were going through a number of similar legal issues. That was 30 years ago. I don't know how much progress we have made since then as to what can be done and not done, but let me just follow up on what Congressman Clay said. And I'm not trying to really be trivial in saying this, but with everything facing Chairman Bernanke and Secretary Paulson and revamping the reg-

ulatory structure in a way that it hasn't been done in over 70 years, to be putting this much effort into something which even the greatest minds in Congress cannot define when it comes to illegal gambling, I wish you well on that.

But very seriously, I think your testimony, and I really appreciate your testimony, and I appreciate your honesty on it, and the questions that are coming show to me either the impossibility of coming up with adequate regulations or meaningful regulations based on the legislation, or coming up with regulations which could have the most dire unintended consequences with severe impact on the financial services industry.

I would just propose, and I'm probably not going to use all my 5 minutes, but since there does seem to be a consensus, including from sports itself, would it make sense to go ahead with regulations dealing with sports and then either put the other aside or allow an administrative law judge to look at it, but at least go ahead with the regulations as it applies to professional and intercollegiate sports?

Ms. ROSEMAN. The challenge is many Internet gambling Web sites, I believe, have a combination of sports gambling and other types of gambling done by the same company. So, again, by the time the transaction gets into the payment system, it would be very difficult for the financial industry to know what type of gambling the payment related to.

Mr. KING. Okay. I don't have the same ability as the chairman of the committee to express outraged hyperbole, but if even on something which everyone agrees is illegal and everyone agrees should be controlled, and if that can't be done, doesn't that just show almost the impossibility of coming up with regulations that would cover an area which no one has been able to fully define?

Ms. ROSEMAN. It does point out that problem. If Congress were to say that any transaction involving a company that had sports betting would be prohibited, that would be somewhat different than prohibiting just the sports betting itself, because the financial industry wouldn't be able to determine the purpose of variuos transactions involving that company.

Mr. KING. I see. Ms. Abend, do you have any comments?

Ms. ABEND. I just concur with what my colleague from the Federal Reserve Board has said, that it is difficult to separate out the differences between, you know, whether it is a sports transaction or some other type of transaction. And, obviously, we have to adhere to what Congress gave to us. So we're just following exactly what we were provided, and there is no provision there really to do with that.

Mr. KING. Okay. Thank you. I yield back.

The CHAIRMAN. Will the gentleman yield to me for one—just briefly?

Mr. KING. If it's appropriate, I would yield.

The CHAIRMAN. Yes. I just—let me say, I had one question based on the line of questioning from my colleague from Texas, Mr. Marchant. You mentioned that there might be a disguise, they might say Joe's T-Shirt Shop, etc. There are penalties for the financial institutions here. Under the regulations, would a financial in-

stitution be under any affirmative obligation to uncover a pattern that might suggest fraud?

Ms. ROSEMAN. Under the proposed regulations, we said that the banks that had the customer relationships with the business customers would have to do due diligence to ensure that those customers were not conducting restricted transactions through their bank. If the pattern of transactions was something that would not look anomalous to their cover activity, I'm not sure if that is something that the bank would necessarily find.

The CHAIRMAN. Okay. But it's important for you not to simply be not sure. We need to know.

Mr. BACHUS. Mr. Chairman, could I respond?

Chairman GUTIERREZ. Excuse me. The gentleman—

Mr. KING. If I have any time left, I yield it to the gentleman from Alabama.

Chairman GUTIERREZ. The gentleman, Mr. King, yields to the gentleman from Alabama.

Mr. BACHUS. Thank you. I think a lot of the questions that have been posed would be better answered by the Justice Department. In fact, Ms. Abend, you said I think on two responses that the Justice Department would be better able to answer those questions. And for the record, before we adjourn this panel, I would like to point out that a number of the questions could have been answered by the Justice Department and they would have been the appropriate party. And for that reason, I, on at least three different occasions, strongly urged and requested the committee to invite the Justice Department, but that request was not honored.

Chairman GUTIERREZ. The recommendation of the gentleman will be seriously considered after today's hearing. I assure him of that.

Mr. BACHUS. Thank you.

Chairman GUTIERREZ. Mr. Wexler is recognized for 5 minutes.

Mr. WEXLER. Thank you, Mr. Chairman. I want to follow Chairman Frank's line of questioning and Mr. Clay's line of questioning. Unfortunately—you're right. You didn't pass this awful law, but you're assigned the responsibility of preparing the regulations. The only appropriate response in my view to what we're hearing this morning is to undo the Unlawful Internet Gambling Enforcement Act in its entirety, and if there are industries that wish to be regulated, whether it's sport industries or whatever, then engage in a consensus. But the idea that we are now taking this law that violates our privacy, invades our freedom, and now applying on top of that a set of regulations that are inconsistent at best and then ask banks to enforce this inconsistency, just exacerbates the situation.

But let me follow what Chairman Frank was beginning to get at, because one of my concerns is the idea that law abiding adults who compete against each other in games based on individual skill such as poker, why wouldn't they be—or I would presume they, too, should be exempt from these regulations. Isn't that correct?

Ms. ROSEMAN. We got a lot of comments from poker players who made exactly that argument. The Act's definition of what is a "bet or wager" includes a game subject to chance. There are a number of games, such as poker, that involve a great deal of skill but probably are also subject to chance. The Act's scope includes games sub-

ject to chance. The Act doesn't require a predominant element of change, but just that the game be subject to chance.

Mr. WEXLER. Well, let's say we are in New Hampshire. If I understand the New Hampshire statute, it describes gambling as a game of chance where the player cannot affect the outcome. Clearly that would not describe poker, as you just described it, and I agree with you. If you take the 5th Circuit's interpretation of the Wire Act, then wagering on poker in New Hampshire is clearly legal. So let's say we are playing poker in New Hampshire, we should be exempt, right?

Ms. ROSEMAN. The Federal Reserve Board is not an expert on gambling law. We have in our consultation with the Department of Justice asked them this question. They believe poker is unlawful under this law. I think that is all I can say.

Mr. WEXLER. Sure. If I understand it correctly with respect to the regulations, is it correct to say that each bank would have to establish its own policy on what transactions to block in compliance and what to permit? And if they got it wrong, they would be liable?

Ms. ROSEMAN. They could either adopt their own policies, or they can rely on the policies of a designated payment system that they participate in. So, for example, if you are a credit card issuer and you rely on the policies of Visa or Mastercard to ensure that the transactions coming through will have a merchant category code that flags this as gambling and will have a code to say that the card was not present when the transaction took place, and then you took actions based on the card system's policies and procedures, you wouldn't then need to go through and develop a—

Mr. WEXLER. But it certainly—

Ms. ROSEMAN. —on your own.

Mr. WEXLER. It is certainly conceivable that different banks or different card systems would have entirely different rules for the same transactions?

Ms. ROSEMAN. In card systems, probably unlikely but certainly conceivable.

Mr. WEXLER. Well, Mr. Chairman, if nothing else, I would suggest that this hearing illuminates the fact that what the underlying bill has established is a totally inconsistent system of regulation of law-abiding adults wishing to play games such as poker or mahjong or chess.

If I could ask one other question. In my district, bridge is a big game, along with mahjong, along with poker. If a group of 78-year-old men and women get together and want to play bridge and they pay an entrance fee of $20 and they register online and they have to use their credit card, is that something that now is going to wind up being a prohibited activity?

Ms. ROSEMAN. I would just be speculating at this point, but I'm not sure if the gambling itself would be online. It would just be the entrance fee, but I had not considered that particular—

Mr. WEXLER. Right. So the majority—the former majority should understand what they did when they passed the Unlawful Internet Gaming Enforcement Act is that they made criminals out of law-abiding Americans who play poker, who play chess, who play bridge, or who play mahjong. And this is all in the context of a

mortgage crisis and a banking crisis in America. Thank you very much, Mr. Chairman.

Chairman GUTIERREZ. And next we have a member of the subcommittee, Mr. McHenry.

Mr. MCHENRY. Thank you. I thank the chairman for yielding time. You know, looking at the law and listening to your testimony, both from my office and then here this morning, I do have just a broader question for both of you. Is it the construct of the legislation that is the issue on issuing regulations and enforcement? Or is it the intent of the legislation? Are you saying in terms of your regulatory capabilities that even the intent of this bill, which is to root out, you know, unlawful forms of gambling, is that possible, in your regulatory view? Or is it simply the construct of this legislation?

Ms. ROSEMAN. I think the challenge is a combination of both things that you mention. Part of it is the construct of the legislation itself that leaves this ambiguity as to what forms of Internet gambling are lawful and which are unlawful. Part of it, though, is the overall intent by having the payment system be the mechanism to combat this unlawful Internet gambling. And as I mentioned earlier, the payment system isn't well designed for this task, and that's really what we're struggling with.

Ms. ABEND. I would agree with my colleague from the Federal Reserve Board that these are incredibly complex issues, and so the statute definition which we took whole into our proposed regulation creates this problem where we—there is this ambiguity that we have seen reflected in the comments that we were provided. And, far be it for me to speculate on the intent of Members of Congress.

Mr. MCHENRY. Okay. All right. Fair enough. That was a very simple answer. I think, Ms. Roseman, back to your comment, you said that the regulations won't be ironclad. I think that was the terminology you used.

Ms. ROSEMAN. Yes. I meant that I don't think it is practical to be able to preclude the payment system from processing any unlawful Internet gambling transactions. There is going to be a proportion that will go through irrespective of our regulation. The question is, how large a proportion.

Mr. MCHENRY. Any estimates? Any ideas?

Ms. ROSEMAN. No. I don't have any estimates on that.

Mr. MCHENRY. So is it safe to say that the construct of the legislation is such that you are both going to have a very difficult time enforcing the legislation we passed? Or is that an understatement?

Ms. ROSEMAN. No. I think it is very difficult without having more of a bright line on what is intended to be included as unlawful Internet gambling. That's the first challenge. I think the second challenge is to figure out how to use the payment system to achieve the objective of cutting off the unlawful Internet gambling activity.

Mr. MCHENRY. Now in terms of your discussions with State attorneys general, have they been extensive? Has there been any discussion on enforcement of this?

Ms. ROSEMAN. No. Our discussions have been with the Department of Justice, but I do not believe we have talked to the State attorneys general.

Mr. MCHENRY. Thank you, Ms. Roseman. Ms. Abend?

Ms. ABEND. I am not aware of any conversations that we have had with them.

Mr. MCHENRY. Okay. Well, thank you for your testimony. Thank you, Ms. Roseman.

The CHAIRMAN. Mr. Chairman?

Mr. MCHENRY. I would be happy to yield to my colleague.

The CHAIRMAN. Thank you. I just wanted to clarify, when the gentleman from Alabama raised the question of the Justice Department, as chairman of the committee, it has generally been our policy to have before us as witnesses representatives from those agencies that come under our jurisdiction. I can't remember a time either recently or in prior years when we had the head of a different agency before us; it becomes a jurisdictional issue. So I understand the concern here, but I can't remember an attorney general or a representative of the Justice Department ever testifying before us. It is generally the case that the committees deal with representatives of the agencies that are under their jurisdiction.

Mr. MCHENRY. What about the FTC, Mr. Chairman?

The CHAIRMAN. We have partial jurisdiction over the FTC statutes. The FTC statutes, for instance, when we did the Privacy Act, we gave some duties to the FTC, among others. So we, whereas as Members—let me be clear—whenever a question of increasing the penalties, for instance, comes up, we don't deal with that. We send it to the Judiciary Committee. So we have a shared jurisdiction over the FTC.

Mr. MCHENRY. I yield back. Thank you.

Chairman GUTIERREZ. I thank the gentleman from Massachusetts, the chairman, for that clarification. Indeed, this bill did go for hearings both before this committee and the Judiciary Committee because of the concerns with the Department of Justice, and we expect to call them at Judiciary to take up the issues with the Department of Justice.

Again, Federal Reserve and Treasury clearly are under the jurisdiction of this committee, and that's why they were called forward, as they are bringing all of the comments forward from the public.

I would like unanimous consent to include in the record comments from the American Greyhound Track Operators Association.

Without objection, it is so ordered.

Would the gentlemen present care for a second round of questions?

The CHARIMAN. We have some members who weren't here for the first round.

Chairman GUTIERREZ. Oh, I'm sorry. Dr. Paul, you are recognized for 5 minutes. I am so happy to see you.

Dr. PAUL. Thank you, Mr. Chairman, and I'm sorry I am late. I had another hearing. But let me just make a very brief statement, and I don't have any particular questions here. But I did want to be on record in opposition to the regulations as well as the legislation that stands dealing with Internet gambling.

I have always taken the position that though I do not endorse gambling per se, people should make their own decisions. It's a personal choice. And I have always been concerned that this type of legislation and regulation is is likely to open the door, as I believe

it already has, to the control and invasion of the Internet itself. And I think the Internet has to be protected.

But I think that there are decisions that individuals make, and they can make mistakes, but I believe those decisions, whether it has to do with how they spend their money or what they put in their mouths or what they smoke, they do it at their own risk. But I also extend that belief to a personal belief that in economics, people ought to be allowed to do that, too, and spend—and have economic transactions at their own risk, and government shouldn't be there to promote virtue or ethical standards, and they shouldn't—the government shouldn't be there to promote what they see as a fair economy.

So it's sticking to those principles that government interference in this manner usually is not beneficial. I have a written statement, Mr. Chairman, that I would ask unanimous consent to submit for the record, and I would like to yield back.

Chairman GUTIERREZ. Without objection, it is so ordered.

Mr. Sherman is recognized for 5 minutes.

Mr. SHERMAN. Thank you. I know the gentleman from Texas is dedicated not only to individual liberty but also States' rights, and gambling has traditionally been regulated by the States. It is not a decision of Congress but technology that has undermined that regulation and it is the attempt of the law that we are dealing with here today to restore what has been a traditional province of the States. I'm sure the gentleman from Texas would agree more with the decision of the State legislature in Carson City than perhaps the State legislature of his own State with regard to whether gambling should be allowed.

The credit card system has been using a coding system to block restricted payments for Internet gambling. I wonder if the witnesses could respond to why this same system wouldn't work for other payment systems.

Ms. ROSEMAN. The card systems have a very different design than other payment systems. The card systems have been designed to include a code going along with the authorization request that indicates what type of merchant the transaction took place at, such as a restaurant, a gaming organization, or an airline.

If you look at, for example, the check system, there is no such code and given the design of the check system, no practical way to include such a code. And so I think it would be very difficult to extend the concept that is in the credit card system to systems such as check system or wire transfer.

Mr. SHERMAN. That is a concise and good answer. I thank you. One of the serious concerns related to Internet gambling is money laundering. Why wouldn't the same procedures used to combat money laundering and terrorist financing work to address illegal Internet gambling?

Ms. ROSEMAN. Money laundering is a global concern. Banks around the world focus on this issue. Many Internet gambling businesses are not in the United States; they are offshore in countries where this is activity is permissible. So the banks in those countries have no incentive to flag those particular transactions because they are legitimate commercial transactions—

Mr. SHERMAN. So we would be in the position of either allowing Internet gambling or cutting our financial ties to those small Caribbean countries if we thought it was more important?

Ms. ROSEMAN. And I think it goes beyond just small Caribbean countries. There could be Internet gambling activity going through major correspondent banks in other countries where it would be impractical for U.S. correspondents to cut off those relationships, which have substantial international payment flows.

Mr. SHERMAN. What is the largest country economically that allows Internet gambling and that demands that U.S. citizens be allowed to gamble over the Internet if the site is located in their country?

Ms. ROSEMAN. That I do not know off the top of my head. I'm sorry.

Mr. SHERMAN. I yield back.

Chairman GUTIERREZ. The gentleman yields back. Are there any further members?

Dr. Paul? Any further questions?

[No response]

The CHAIRMAN. If I could just get an answer to the question about whether or not it makes a difference if you're in the 5th Circuit, because the 5th Circuit did in 2002 give a ruling on the legality of some horse race betting. I know Justice doesn't agree. Under the regulations, would it make any difference if I were a financial institution in the 5th Circuit or if the activity happened in the 5th Circuit?

Ms. ROSEMAN. If you're talking about horse racing—

The CHAIRMAN. Yes.

Ms. ROSEMAN. In our regulation, we did explicitly exclude horse racing permitted under the Interstate Horse Racing Act, as did the Act itself. We just did not define—

The CHAIRMAN. Well, I understand that. But the Justice Department is saying one thing. The 5th Circuit has had a ruling. Does it make any difference? Do I get any protection from the fact that the 5th Circuit has ruled that it is permitted?

Ms. ROSEMAN. I would assume if you were in the 5th District, you would have that protection—

The CHAIRMAN. In the 5th Circuit?

Ms. ROSEMAN. —from that court's rulings.

The CHAIRMAN. One last question. You said those contests, you could bet on those contests which were a combination of skill and chance. Would it be legal to bet on elections under this?

[Laughter]

Ms. ROSEMAN. You know, we posed that question recently to the Justice Department because there are predictive markets Web sites where you could bet on the outcome of a presidential election and a number of other things. Justice considered that subject to chance. That was their interpretation.

The CHAIRMAN. So that is illegal?

Ms. ROSEMAN. That is their interpretation.

The CHAIRMAN. Betting on an election. Thank you.

Chairman GUTIERREZ. I believe Dr. Paul has some documents to submit.

Dr. PAUL. Right. Mr. Chairman, I ask unanimous consent to submit two letters on behalf of Congressman Bachus.

Chairman GUTIERREZ. Without objection, it is so ordered.

The CHAIRMAN. Let me just say, because my colleague from Florida raised New Hampshire, at this point I am prepared to say that the New Hampshire primary is pretty much a game of chance.

[Laughter]

Chairman GUTIERREZ. Let me thank the witnesses. I will tell both Ms. Abend and Roseman that I have chaired about half a dozen of these hearings, and I have never had this kind of participation and activity, which says be careful about where you go with these regulations. I mean, there is a lot of interest. Obviously, there is a lot of interest on the part of the members of this committee and the Members of the House of Representatives, at least if the participation today is any indication, and I think it is an indication.

So we will work with you as we move forward. I just think you have one heck of a complicated job when, you know, you have major broadcasters saying the Kentucky Derby, everybody knows the gentlemen are betting. And for those of you who—I mean, there is so much betting going on in America that this is going to be a very difficult challenge for you. I hope you can outlaw the foursome in front of me on the golf course on those spots stopping those bets, so that I can get through the day a lot quicker.

[Laughter]

Chairman GUTIERREZ. Thank you so much. We will—

The CHAIRMAN. And Mr. Chairman, I think there are only three votes, so we should be back fairly quickly.

Chairman GUTIERREZ. We will adjourn to vote and come right back. Thank you so much.

[Recess]

The CHAIRMAN. [presiding] Thank you. The first panel was a lengthy one, but I don't think to the disappointment of any of those who are here with us. Chairman Gutierrez has Judiciary Committee business, and they are voting, so I will start this off.

We have our second panel of people from the financial service industry in particular, and we will begin with Harriet May who is the president and chief executive officer of GECU of El Paso, and she is speaking on behalf of the Credit Union National Association. Please tell our former colleague, Mr. Mica, our good friend, not to worry about the proposal to abolish the credit unions. We would never do that. So we will just ignore that part of the Paulson plan. Don't worry about anything. You can go ahead.

STATEMENT OF HARRIET MAY, PRESIDENT AND CEO, GECU OF EL PASO, TEXAS, ON BEHALF OF THE CREDIT UNION NATIONAL ASSOCIATION (CUNA)

Ms. MAY. That is a very nice welcome, Mr. Chairman, and thank you for allowing me to testify before this subcommittee. The issue of the Unlawful Internet Gambling Enforcement Act of 2006 is disconterting, and it is my privilege to testify on behalf of the Credit Union National Association.

I am, as you said, Harriet May, president and CEO of GECU in El Paso, Texas. I am a member of the CUNA Board of Directors

and serve as CUNA's board secretary. CUNA is the largest trade association for credit unions, representing 90 percent of the Nation's 8,400 State and Federal chartered credit unions, which in turn serve over 90 million members.

GECU, formerly known as Government Employees Credit Union, has served the families of El Paso since 1932, and we're the largest locally owned financial institution in the area, with just over $1.4 billion in assets and serving over 277,000 members.

When I received the invitation to appear today, I must say I relished the opportunity to talk with you about the range of serious and practical concerns that CUNA believes will make compliance under the Act extremely difficult, if not impossible, for financial institutions.

One of our most fundamental concerns with the implementation of this law is that credit unions and other financial institutions are in business to provide financial services to communities, and we are already burdened with heavy policing responsibilities. For example, our compliance duties under the Bank Secrecy Act and Office of Foreign Assets Control rules are extraordinary. We do not think that the Internet gambling law could possibly be implemented without creating a list similar to that published by OFAC.

We are equally concerned that while institutions would be required to identify and block transactions that fund illegal gambling activities, the proposed rules provide no mechanism to verify when a payment transaction is intended for illegal Internet gambling.

H.R. 2046, the Internet Gambling Regulation Enforcement Act, introduced by House Financial Services Committee Chairman Barney Frank, would require Internet gaming businesses to be licensed and pay user fees to the Financial Crimes Enforcement Network. The bill could be the vehicle for the Department of Justice to take the lead in not only monitoring the entities that are complying with registration but also developing a list of those businesses or individuals involved in illegal Internet gambling activities. Such an approach would promote compliance for institutions by providing them a greater level of certainty as to whether a transaction for a particular entity should be prevented. Exemptions and safe harbor provisions would help provide a regulatory framework that might actually work.

Under the Act, institutions must establish and implement policies and procedures to identify and block restricted transactions or rely on those established by the payment systems. We are concerned that the scope of these requirements is not realistic. To illustrate, the proposal calls for participants, including card issuers, to monitor certain Web sites to detect the unauthorized use of a covered payment system, and to monitor and analyze payment patterns. Such activities would be time consuming and detract from an institution's own business purposes.

Also, the proposal directs covered entities to address due diligence without defining or explaining what is meant by that term. In addition, the Act states that institutions that reasonably believe a transaction is restricted will not incur liability for incorrectly blocking the transaction. We appreciate the safe harbor but need clear guidance on what is necessary for institutions to show that their belief was reasonable. The Federal financial regulators will be

responsible for enforcing the rule. However, it is not clear how this enforcement would occur.

And lastly, the Act does not include an effective date. While we do not believe this proposed regulation should be promulgated, if the agencies are required to proceed, institutions should have at least 18 months if not longer to determine how to meet the new requirements.

And in summary, Mr. Chairman, CUNA certainly appreciates your leadership in reviewing this matter. We don't condone illegal Internet gambling or want to see it continue or grow. However, the current statute and implementing proposal contain several components of great concern. We respectfully urge that the proposal not be finalized and that Congress take action to address hardships that would otherwise arise.

Thank you, Mr. Chairman.

[The prepared statement of Ms. May can be found on page 91 of the appendix.]

The CHAIRMAN. Ms. May, thank you both for the cogency and for being the first witness I have ever seen in 28 years hit 5 minutes exactly.

[Laughter]

The CHAIRMAN. May your tribe increase.

Ms. MAY. Thank you.

The CHAIRMAN. I thought your testimony was also substantively very welcome.

Next we have a familiar face for us, Wayne Abernathy, who is testifying on behalf of the American Bankers Association. Mr. Abernathy.

STATEMENT OF WAYNE A. ABERNATHY, EXECUTIVE VICE PRESIDENT, FINANCIAL INSTITUTIONS POLICY AND REGULATORY AFFAIRS, AMERICAN BANKERS ASSOCIATION (ABA)

Mr. ABERNATHY. Thank you, Chairman Frank. We appreciate this opportunity to comment on the Unlawful Internet Gambling Enforcement Act of 2006 and the proposed rule implementing the Act. ABA members have a strong record in the fight against financial crime. We have invested enormous resources in fulfilling our obligation to report criminal or otherwise suspicious activity under the anti-money laundering laws.

The Unlawful Internet Gambling Enforcement Act takes banks beyond the role of reporting potentially or allegedly illegitimate financial activity, and makes financial institutions the police, prosecutors, and judges in place of real law enforcement officers when it comes to the practice of unlawful Internet gambling.

Banks are saddled with this exceptional burden, using the words of the Act, "Because traditional law enforcement mechanisms are often inadequate for enforcing gambling prohibitions or regulations on the Internet." That is to say, all the sophistication of the FBI, Secret Service, and other police investigation methods is inadequate to apprehend the unlawful gambling business or confiscate its revenues.

ABA believes that punting this obligation to the banking industry is an unprecedented delegation of governmental responsibility, with no prospect of practical success.

The modern payment system is constructed to facilitate fast, reliable payments at low cost. It is no exaggeration to say that nearly all other economic activity in the Nation, in one way or another, relies upon the payment system. Hundreds of millions of payments are processed each day, about 100 billion each year. The burdens placed upon financial institutions by the Act would compromise the efficiency of the payment system and yet would not curtail Internet gambling.

At the core of the problem is the lack of a usable definition of "unlawful Internet gambling," a definition that neither the statute nor the regulations provide. Banks would be required to institute policies and procedures to block unlawful transactions without being sure which parties or transactions to block and when. This is not a reasonable undertaking.

It is one thing for banks to report suspicious activity based upon their judgment of the possibility of illegal conduct. It is quite another to require a bank to act on its own judgment about legality and impose sanctions for such determinations. ABA believes that the flaws in the definition of "unlawful Internet gambling" are fatal to this effort as a legal policy and a practical matter.

Even if a good definition could be devised, identifying commercial customers engaged in unlawful Internet gambling is very difficult. All commercial customers would be subjected to screens, filters and other processes that might be developed in the effort to enforce the law. These screens and other processes would almost entirely depend on information obtained from the customers. Since neither illegal Internet gambling enterprises nor their customers are likely to be up-front about their activities, monitoring transactions will fail to catch most illegal gambling payments.

The cross-border provisions of the act and the proposed rule further complicate the situation. They require financial institutions in the United States to rely on foreign correspondent banks to interpret and enforce the Act, a responsibility that is not supported by international law.

In conclusion, there are realistic limits to how the payment system can be used effectively to solve the problems raised by illegal Internet gambling. The Act and the proposed rule do not provide a rational path towards halting unlawful Internet gambling. Rather, the path leads to increased cost and administrative burden for banks, and erosion in the performance of the payment system, without stopping illegal Internet gambling transactions.

Thank you very much, and I'm happy to take any questions.

[The prepared statement of Mr. Abernathy can be found on page 45 of the appendix.]

The CHAIRMAN. Thank you, Mr. Abernathy.

And next we have, testifying on behalf of the Financial Services Roundtable, Mr. Leigh Williams.

STATEMENT OF LEIGH WILLIAMS, BITS PRESIDENT, THE FINANCIAL SERVICES ROUNDTABLE

Mr. WILLIAMS. Thank you, Chairman Frank, for the opportunity to testify on the proposed rules arising from the Unlawful Internet Gambling Enforcement Act, and on H.R. 2046, the Internet Gam-

bling Regulation and Enforcement Act, which contemplates the creation of a regulatory framework for permissible online gambling.

My name is Leigh Williams, and I am the president of BITS, the operations and technology division of The Financial Services Roundtable. My members, 100 of the largest U.S. financial institutions, have carefully reviewed the proposed rules, and I would like to share three impressions from that review with you this afternoon. Our full analysis is available in a comment letter which we filed with the Federal Reserve and the Treasury and which was submitted with my written testimony.

To provide context, let me say first that as a former chief risk officer and as BITS president, I share the concern of the subcommittee and the agencies about potential abuse of the financial payment system for illegal purposes. My members devote substantial resources to knowing their customers and identifying suspicious transactions. Fraud prevention has become an industry core competency, in fact, and individual firms have literally hundreds of people dedicated to anti-money laundering programs, OFAC blocking, and suspicious activity reporting.

I am, however, concerned that this policing activity may be reaching a point of diminishing returns, where its cost in risk management resources and customer disruption may be greater than its benefit in enforcement. I have three concerns in particular about facets of the proposed rules that elevate the compliance burden without commensurate benefit.

First, the agencies have chosen not to fully define "unlawful Internet gambling," as we have heard this morning, but they presume that institutions could assemble and interpret definitions themselves based on pronouncements from the Justice Department and others. The very complexity that deterred the agencies from issuing a definition will be multiplied a thousand fold if thousands of institutions are required to establish their own working definitions.

We urge the subcommittee and the agencies to work toward more specificity on the scope of "unlawful Internet gambling."

Second, the rules require that institutions block the use of the payment system by known unlawful gambling businesses or for funding known unlawful gambling transactions, but they do not specify whether this knowledge should come from existing monitoring activities or if additional policing is expected. Requiring institutions to act on knowledge arising from current surveillance is a more reasonable expectation than requiring an entirely new layer of surveillance.

We urge the subcommittee and the agencies to moderate the operational burden of the rules by leveraging rather than supplementing our current policing efforts.

Finally, my members are concerned about the legal exposure associated with both false positives and false negatives. In spite of our best efforts, we are likely to block some legitimate business, and we may well miss some well-concealed illegal activity. If institutions are to be given police powers, and in fact policing obligations, some limited form of the liability shield granted to public servants should also be granted to institutions applying their policies and procedures in good faith and in the public interest.

Before I close, I'd like to comment briefly on H.R. 2046, the Internet Gambling Regulation and Enforcement Act. I will leave it to the judgment of the Congress whether to allow or prohibit online gambling, but I will offer my thoughts on the extent to which the bill might moderate my three stated concerns about the proposed rules:

First, creating a distinct category of permissible regulated gambling will reduce and may nearly eliminate the unlawful Internet gambling that we otherwise may be required to define. The scope of prohibited activity will be narrower, and with FINCEN's proposed involvement, it should also be clearer.

Second, the licensing of legitimate operators will simplify our institutions' surveillance activities by identifying a population of customers that we know are subject to specific requirements. However, the question remains of our institutions' duty to identify covert gambling operations and concealed gambling transactions.

Finally, by creating a class of regulated gambling entities and then requiring that FINCEN actively police them, the bill may relieve some of the burden and legal exposure associated with our institutions serving in this role.

While these concerns and others noted in our comment letter may not be entirely resolved by H.R. 2046, in my judgment the compliance burden to financial institutions would be substantially moderated.

In closing, let me express my confidence that financial institutions will do everything that the final rules require of them, and many will do more. I urge only that the subcommittee and the agencies do everything in their power to be as clear and judicious as possible about what is expected.

Thank you for your time. I would be happy to answer any questions.

[The prepared statement of Mr. Williams can be found on page 105 of the appendix.]

The CHAIRMAN. This is a good day. You were also right on time. I am very grateful, because you have all put a lot of very substantive stuff in here. And finally, we have Mr. Ted Teruo Kitada, the senior company counsel of the Legal Group at Wells Fargo.

STATEMENT OF TED TERUO KITADA, SENIOR COMPANY COUNSEL, LEGAL GROUP, WELLS FARGO & COMPANY

Mr. KITADA. Thank you, Chairman Frank, for this opportunity to testify today regarding the Unlawful Internet Gambling Enforcement Act of 2006 and proposed regulations under this Act.

In reviewing the proposed regulations and the Act, Wells Fargo has identified certain key issues. We would like to briefly highlight two of them for the committee:

The definition of "unlawful Internet gambling" and the possible application of the final regulations to existing customers.

First on the definition of unlawful Internet gambling, while the term is a core definition under the Act, "unlawful Internet gambling" is not clearly defined in the regulations. This term is defined as placing, receiving, or transmitting a bet or wager by means that involves the use of the Internet "where such bet or wager is unlawful under any applicable Federal or State law."

By referencing the State or Federal laws, the banking industry is burdened with the responsibility of identifying, interpreting, and applying those laws. We handle at Wells Fargo a significant number of transactions daily, and just to have some sense of the volume, I have set forth the numbers with regard to ACH, check, and wire systems transactions.

For the ACH system, we originate in excess of approximately 3.1 million debit transactions daily. As a receiving depository financial institution, we receive daily approximately 1.2 million credit transactions. In the check collection system, we handle daily about 11 million checks. In the wire transfer system, where as a beneficiary's bank, we have responsibility to identify restricted transactions, we handle approximately 25,000 to 30,000 wire transfer transactions daily.

As an originator's or intermediary's bank, with regard to wire transfers directly to foreign banks, we handle about 5,000 to 6,000 thousand transactions daily.

As you can see by just the sheer volume of transactions that we handle, having the responsibility to identify and block restricted transactions would be a significant undertaking for us.

Next on the applicability of the proposed regulations to existing customers, we are concerned that when the final regulations are issued, those regulations will apply to our existing customers. We have presently about 24 million consumer customers and about 1.8 million business customers, and we are concerned that the final rules will apply to that population.

Under the USA Patriot Act, we have been complying with the due diligence requirements under the regulations issued under the Act since October 1, 2003, but there is a significant number of customers about which we may know less because those customers have not been subject to the robust due diligence requirements under the USA Patriot Act.

There are further requirements under the proposed regulations to implement policies and procedures with regard to the existing customers. As a merchant customer provider, Wells Fargo has approximately 140,000 merchant customer relationships. We would be required under the best practices advanced under the proposal to adopt amendments to those merchant agreements to provide that those merchants were not introduce restricted transactions to the card system. We are concerned about that requirement.

As the originator's bank and intermediary bank on foreign wire transfers going directly to foreign banks, we are required to block and perhaps even close those relationships where we have identified restricted transactions.

We are concerned that in connection with those rights, amendments to existing foreign banking relationship agreements would be necessary and that we will have to provide for such amendments with over 200 correspondent foreign banking relationships.

These observations conclude my remarks, and I will be pleased to field any questions the committee may have. Thank you.

[The prepared statement of Mr. Kitada can be found on page 59 of the appendix.]

Chairman GUTIERREZ. I recognize the subcommittee ranking member first, so, Dr. Paul, you are recognized for 5 minutes.

Dr. PAUL. Thank you, Mr. Chairman.

Chairman GUTIERREZ. Thank you.

Dr. PAUL. I have a couple of brief questions for the panel. Anybody who feels like answering them can. They are general, and you may have touched on this in your testimony, but I wanted you to emphasize it if you have not.

First, I want to talk about the potential cost that might be put on you for doing this. There always has to be a dollar cost when we write regulations, nobody really knows about it, but I'm sure you have anticipated it. Is there any way you can quantify that figure? "Well, this is going to cost me so much." I was in the medical field and they would come in with regulations and we would have managed care. All of a sudden, you might have to hire three new people for your office.

I'm wondering whether there's a cost, do you have to have more people involved and looking after regulations like this and the hours that might be involved?

The other concern I have is the amount of records that we keep. There has been financial regulation for a long time, since the 1970's when it really got busy and required a lot of financial regulations, and even before 9/11, there was a tremendous amount of financial regulation sitting out there. And it gets to the point where the regulations and the information that is accumulated loses its effect because there is too much.

So there is a lot of information on innocent people, and then the people who figure, well, we're going to do this illegally, maybe they will have a trick, and it really doesn't achieve what you are supposed to be achieving. I'm just wondering whether you see that as a complication where, yes, you can do your best and accumulate a lot of records, but there will be so many records that nobody gets to sort these out. In spite of all the technology we have here, government sometimes tend to be inept and they have too much information, so they can't make good use of it.

And the other point that I want to ask about is, do you feel like there's a burden placed on you unfairly where you might have to make a judgment and a decision on what is legal and what is illegal? Is that burden ever placed on you where it seems like that is one of the proper roles of government, deciding what is legal and illegal rather than putting the burden on the business person or financial institution to decide, oh, it's my judgment, you know, to decide what is illegal and what we should report?

Those are the general concerns I have. Does anybody want to make any comments on those issues?

Mr. ABERNATHY. Yes, if I may, Congressman Paul, can I take them in reverse order?

Dr. PAUL. Fine.

Mr. ABERNATHY. Because I think that is the way that really sets up the questions. The first problem really is, what makes this requirement different from, for example, the Bank Secrecy Act, Anti-Money Laundering, is that under this piece of legislation and the regulations that will back it up, we're required not only to identify whatever might be unlawful, but we're actually required to impose a sentence. We're told to deny financial services to someone whom

we determine is engaged in unlawful activity, unlawful Internet gambling.

So the first problem is, this goes beyond reporting, which is what we do under BSA. Under the Bank Secrecy Act, Anti-Money Laundering, we see something that we think is improper, and we report that. And the law enforcement folks then take their responsibility and they do what they feel is appropriate to do with that. We are now told, look at it. If you determine it's wrong, you impose the sentence. And we think that's a step too far in devolving governmental responsibility.

That leads to the second point, which I think requires a comparability in terms of cost. It's very difficult really to put a cost on something that isn't in place yet, and particularly if it's something that could go in any number of different ways in terms of how the enforcement burden is defined. But I would give as an analogy the costs that are imposed under the Bank Secrecy Act, even though taking into account how that's different from what I said.

A typical $100 million bank, a bank with $100 million in assets—that is about the size of the average ABA member, although we have banks of all sizes in our membership—tells us that they have two to three employees who do nothing but compliance efforts with Bank Secrecy Act/Anti-Money Laundering. They don't do anything to serve a customer. They don't provide loans. They don't provide any service other than meeting the paperwork burden. And as you correctly point out, nearly all of that burden is gathering data on law-abiding people conducting legal transactions. That is how this could eventually evolve.

And then the last point that I would make, what defies really predicting the cost of all of this is we don't know what is unlawful, what is illegal, and as long as that burden is upon us, estimate it is going to be pretty close to impossible.

Dr. PAUL. Thank you. Any—

Mr. WILLIAMS. Mr. Paul, if I might offer a couple of comments regarding cost. One is that I would echo what Mr. Abernathy has said about the regulatory uncertainty ironically making it very difficult for us to estimate what the ultimate cost of compliance might be.

Chairman GUTIERREZ. The gentleman's time has expired. Chairman Frank is recognized for 5 minutes.

The CHAIRMAN. Mr. Kitada, I'm told in your comment letter and elsewhere you have also noted that we can't be sure what entities are covered, that "financial institution," as the statute defines it, may sweep more widely than people would ordinarily think. Could you comment on that?

Mr. KITADA. With regard to the definition of financial institutions—

The CHAIRMAN. The transmitters of money.

Mr. KITADA. Oh, money transmitters? Yes. Under the Act, there's a reference to the definition of money transmitters, and in contrast, there's also under the regulations issued by the Treasury under a definition for money service business, and with regard to the money service business, there is a exclusion or safe harbor for check cashers that cash items regularly for under $1,000. And there's no such exclusion under the Act. And so consequently, with

regard to money transmitters, that population of check cashers who heretofore may have enjoyed a safe harbor under the Bank Secrecy Act, will now become subject to this Act and to the requirements for developing policies and procedures. And it also raises some challenging questions for the industry in terms of policing the behavior of money transmitters.

The CHAIRMAN. Well, that is very important. That is what I wanted to get to. And, again, I want to stress, we can divide this. Congress of course has the right, I believe, to ban gambling. I don't agree with it. I share the views of my colleague from Texas and others that it ought to be a matter of personal liberty.

But there is a second question, if we decide to do it, as to how to do it. And in effect, what this does, this law, is to draft the financial service industry, in effect deputize the financial service industry and turn them into the enforcers of the law. It seems to me we can go at this at the two levels.

But here is part of the problem. You have due diligence requirements, etc. You have all these customers. What troubles me is, and there is a letter from Grover Norquist on behalf of a coalition of organizations raising questions about privacy. What I am afraid of is that there is a conflict between the obligation imposed on you by the Act to do due diligence and to see whether or not people are trying to get around this, and the privacy expectations of your customers.

Mr. Abernathy, is that an accurate description of the dilemma?

Mr. ABERNATHY. I think that's very accurate. A bank is really in the position of having to make one decision: cut off all transactions that look in any way like they might be heading toward illegal Internet gambling, or become very intrusive in the kinds of questions we ask, so that we can make the decision the Act forces us to make.

The CHAIRMAN. And one of the things it will do, as I said, is to draft you to be the law enforcement people. We have seen this in other cases. What you can envision is a tremendous increase in complaints about the financial institutions to the consumer protection agencies because the Federal Government has made you do it.

And a lot of customers who are going to find themselves having their transactions cut off or blocked aren't going to realize that this is something imposed on you by the Federal Government. I think the recipe for problems here is just enormous, because you are being put in this position where you have to do this.

Let me go back to the horse racing question. If I am a bank, do I have to block someone who has made a bet on a horse race in a State where horse racing: (a) was legal; (b) wasn't legal; (c) wasn't legal, but it is in the 5th Circuit; or (d) all of the above?

Mr. ABERNATHY. I think one of the problems is, even though you might know where the race took place, you don't know where the bet is coming from, if you're talking about the Internet.

The CHAIRMAN. And that's the determinant, not where the race took place—so in other words—okay.

Mr. ABERNATHY. You have two or more places you have to be worried about—where did the transaction take place, where did the event take place, where did the person who was doing the activity, where were they when—

The CHAIRMAN. I don't have to meet both. And of course, it would never—well, presumably it would never be legal to bet on the—or we don't know that. I mean, what do you advise your client then?

Mr. ABERNATHY. We would advise them—I mean, we frankly, as a trade association, can't give them specific advice, but what I suspect they would do is they would just block the transaction, and that gets back to Mr. Paul's point. We would block a lot more legal transactions in the effort to avoid being tagged for failure to block the illegal one.

The CHAIRMAN. One of the issues that has been occupying us is the competitive aspect. We have been told that we have to be careful, whether it is Section 404 of Sarbanes-Oxley or other things, about driving financial business out of America. If we were to adopt tomorrow as the major league sports—as the major sports league want, if we were promptly to adopt the pending regulations, would that have any effect on the competitive position of American financial institutions in the world?

Mr. ABERNATHY. I think the biggest impact would be that it begins to—well, more than begins—it continues to compromise the quality of the payment system. It's not just the banks themselves, but you're now putting a new burden on what is one of the fundamental purposes of the banking system, and that is to make sure payments can be made between parties as quickly, as efficiently, and at as low a cost as possible. We have now compromised that.

The CHAIRMAN. Any others?

Mr. WILLIAMS. I think there are three ways, Mr. Chairman, that we might undermine competitiveness. One is we might be required to increase compliance costs to the point where they would become a threat. We might disrupt customer service, particularly in this overblocking to the point where that would become a real issue, or we might divert resources from other more critical risk management activities. And that also could put the industry and customers at risk.

The CHAIRMAN. I am going to close by saying, as the chairman of this committee, that we have some responsibility to try and facilitate the functioning of the financial system. You know, just as you are being drafted by the bill, I think our committee was drafted, although by its own leadership, to do this. If our colleagues want to go on an anti-gambling crusade, well, I can't stop them necessarily, but I would hope we could stop them from burdening this committee and our jurisdiction, the financial services institutions, from getting entangled in it.

Thank you, Mr. Chairman.

Chairman GUTIERREZ. Are there any further questions from members of the subcommittee?

[No response]

Chairman GUTIERREZ. I want to thank the panel for having come together, because I think we have had a rather rich discussion where Dr. Paul and Chairman Frank really don't want us involved in the regulatory matters at all in terms of legislating the morality of gambling and betting.

I might be convinced that there might be some use to doing that here in Congress, but what I'm not convinced is that financial institutions should be the sheriff, should be the people making the deci-

sions. Because I think that you have a relationship with the public in general which is much more important than this one, and I just don't know how we do it.

And so we're going to be very careful with Treasury and the Federal Reserve Board as they come up with the regulations, because if you have never gotten your credit card statement and made a call to your credit card company about a particular billing amount because you didn't recognize the store, you didn't recognize the amount, maybe you're not being as careful as I and others are when they get their credit card statements, because I have certainly on many occasions had to call my credit card company so they could explain to me the company and the nature, because there are so many companies that when you charge something, have a totally different name when it comes up on your credit card. Now when they tell you the address and what they do, you're okay, I remember, I did that. That was a charge.

So we all do that day in and day out, checking our credit card statement. I would hate to think about what banks and other financial institutions and credit card companies would have to do in order to do that. And I'm no great friend of the credit card institutions and financial institutions and feeling sorry about their processing of forms, because many times when I call, I find out that $2 overdraft on that Starbucks coffee which they said we just couldn't avoid is all of a sudden $120.

And I know all of you know that happens every day in America. You get a debit card, give it to your kid, you figure they can't use—now, interesting, they can't get the $2 in cash, but they can get the overdraft of $2 on that Starbucks coffee on that day. And it will take them a week, and it's $10 a day and it's $20.

So, I'm not here as a standard bearer for the credit card companies and the kinds—but I would think having an honest discussion about those overdraft statements and how much companies can charge is a much better function of the Financial Services Committee and regulating our economy and our relationship between your institutions and the public in general than doing the gambling thing. And how we do remittances and payday lending, and the extraordinary amounts of interest to the American public. I just think that those are much more important issues that I would like to engage all of you in.

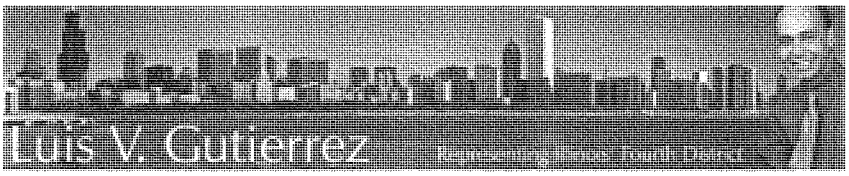
I appreciate your comments. I thank you for the comments that you made during the open period. I will tell you that I take them very, very seriously, as I know all of the members of this committee so, and without any further questions, I thank the members of this panel. I thank the previous panel, and I thank all of those who have come to participate in this hearing on gambling.

Thank you so much.

[Whereupon, at 12:52 p.m., the hearing was adjourned.]

A P P E N D I X

April 2, 2008



* **For Immediate Release** *
April 2, 2008

* **Media Contact** *
Rebecca Dreilinger 202-225-8203

REP. LUIS GUTIERREZ OPENING STATEMENT: PROPOSED REGULATIONS TO THE UNLAWFUL INTERNET GAMBLING ENFORCEMENT ACT (UIGEA)

Washington, DC – U.S. Representative Luis V. Gutierrez (D-IL), Chairman of the Subcommittee on Domestic and International Monetary Policy, Trade and Technology, today made the following statement at a Subcommittee hearing entitled, "Proposed UIGEA Regulations: Burden without Benefit?"

"The focus of today's Subcommittee hearing is the proposed regulations to implement the Unlawful Internet Gambling Enforcement Act of 2006.

"The Act prohibits the U.S. payment systems from accepting payments for bets or wagers made by U.S. citizens who seek to gamble online. The Law also requires the Federal Reserve Board and Treasury Department to issue regulations mandating that payment systems identify and block all restricted transactions.

"In October 2007, the draft regulations were issued, and more than 200 comments were filed in response. As proposed, the regulations would require most companies involved in the payment systems – from banks to credit card companies to money transmitters and payment processors – to develop and implement policies and procedures designed to identify and block unlawful Internet gambling transactions.

"The regulations have been widely criticized as being vague and costly for financial institutions to implement. One of the most common complaints is that the proposed rules fail to sufficiently define key terms, leaving financial institutions with significant compliance difficulties.

"For example, the regulation fails to adequately define what constitutes "unlawful Internet gambling" or a "restricted transaction," yet requires the financial institutions to make a determination on their own about what is lawful or unlawful.

"If the rule is adopted in its current form, the response by many financial institutions will likely be to over-block transactions to protect themselves from legal liability.

"Although the regulation does provide a safe harbor for financial institutions that block transactions that are in fact legal, it does nothing to ensure that ***legal*** transactions are not blocked. As a result, consumers will be placed at risk of having lawful transactions blocked. It is easy to see how these regulations, if implemented in their current form, could wreak havoc on electronic commerce in the U.S.

"With that in mind, I want to take a moment to question the priorities reflected by the underlying law, which was passed while my party was in the minority, and which seeks to eliminate Internet gambling by adults. In my opinion, if Congress is going to impose additional regulations on financial institutions, our time would be better spent restricting payday lending or curbing unfair and deceptive practices associated with credit card accounts and other types of predatory lending.

"But, the reality is we have a law that requires the regulators to develop rules to ban Internet gambling. And I have several concerns with the proposed rules.

"First, I am concerned about the effect these regulations will have on the remittances system that immigrants use to send billions of dollars home each year. Money transmitter companies are already having problems maintaining accounts with some banks, and I fear that this rule could exacerbate that problem.

"I am also troubled that these regulations could impose significant compliance burdens on financial institutions during a time of economic and financial turmoil.

"Finally, I believe it is inappropriate to have financial institutions essentially acting as the final arbiter in determining which transactions are legal or illegal; especially when the result could be closing a consumer's account.

"This hearing will provide an opportunity for the regulators to address these and other issues concerning the proposed rules. We will also have the opportunity to hear directly from the financial services industry on the potential cost, regulatory burden, and compliance issues they anticipate if the regulation is implemented as proposed.

"I expect a vigorous debate on the issues, and the Committee looks forward to working with the regulators as they move through the process and decide whether to amend the regulations or roll the dice and adopt them in their current form."

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Congressman Ron Paul
Statement before the Financial Services Committee
Subcommitte on Domestic & International Monetary Policy
U.S. House of Representatives
Hearing on Proposed UIGEA Regulations
April 2, 2008

Mr. Chairman,

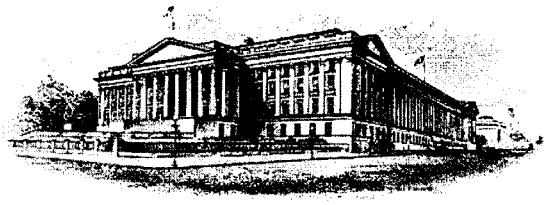
I stand opposed to the regulations being discussed today because I opposed the underlying bill upon which these regulations are based. The ban on Internet gambling infringes upon two freedoms that are important to many Americans: the ability to do with their money as they see fit, and the freedom from government interference with the Internet.

The proper role of the federal government is not that of a nanny, protecting citizens from any and every potential negative consequence of their actions. Although I personally believe gambling to be a dumb waste of money, American citizens should be just as free to spend their money playing online poker as they should be able to buy a used car, enter into a mortgage, or invest in a hedge fund. Risk is inherent in any economic activity, and it is not for the government to determine which risky behaviors Americans may or may not engage in.

The Internet is a powerful tool, and any censorship of Internet activity sets a dangerous precedent. Many Americans rely on the Internet for activities as varied as watching basketball games, keeping up on international news broadcasts, or buying food and clothing. In the last few years we have seen ominous signs of the federal government's desire to control the Internet. The ostensible reasons are to protect Americans from sex offenders, terrorists, and the evils of gambling, but once the door is open to government intrusion, there is no telling what legitimate activity, especially political activity, might fall afoul of government authorities.

The regulations and underlying bill also force financial institutions to act as law enforcement officers. This is another pernicious trend that has accelerated in the aftermath of the Patriot Act, the deputization of private businesses to perform intrusive enforcement and surveillance functions that the federal government is unwilling to perform on its own.

In conclusion, I urge my colleagues to oppose these new regulations and support Chairman Frank's HR 2046, of which I am a cosponsor. Although this bill has been criticized by some for its regulatory aspects, this act does not create any new federal laws and merely ensures that Internet gambling firms comply with existing federal law. The passage of HR 2046 would restore the right of Americans to decide for themselves whether or not to gamble online.



U.S. TREASURY DEPARTMENT OFFICE OF PUBLIC AFFAIRS

EMBARGOED UNTIL 10 a.m. (EDT), April 2, 2008
CONTACT Jennifer Zuccarelli, (202) 622-8657

DEPUTY ASSISTANT SECRETARY VALERIE ABEND TESTIMONY ON IMPLEMENTATION OF REGULATIONS REQUIRED BY THE UNLAWFUL INTERNET GAMBLING ENFORCEMENT ACT OF 2006

WASHINGTON – Mr. Chairman, Ranking Member Paul, and Members of the Subcommittee, it is my privilege to appear before you today to discuss the Unlawful Internet Gambling Enforcement Act of 2006 (the "Act").

Proposed Rulemaking

The Act was fashioned to require payment systems to interdict the flow of funds from gamblers to businesses providing unlawful internet gambling services. To accomplish this, the Act requires the Treasury Department and the Federal Reserve Board, in consultation with the Justice Department, to jointly prescribe regulations requiring participants in designated payment systems to establish policies and procedures that are reasonably designed to prevent or prohibit such funding flows. It also requires that payment systems, or portions of payment systems, be exempted in situations in which it would not be reasonably practical for payment systems to prevent or prohibit unlawful internet gambling transactions.

On October 4, 2007 the Treasury Department and the Federal Reserve Board, after consultation with the Justice Department, published a Notice of Proposed Rulemaking seeking public comment. Our goal when writing this proposed rule was to faithfully adhere to the mandates set forth by Congress in the Act. The comment period ended on December 12, 2007.

We received more than 200 comments from a diverse group of interests, including entities potentially subject to the proposed regulations, individuals and groups supportive of internet gambling, individuals and groups opposed to internet gambling, as well as others.

We are currently reviewing each comment closely, and analyzing the issues presented. Many comments present more than a single issue, and certain issues require additional research into operations of various parts of payment systems, or into existing law relevant to the comment provided.

Some of the comments address the meaning of statutory definitions provided by Congress, the applicability of requirements to specific portions of designated payment systems, and the impacts this proposed regulation could have in the event it were to be finalized as proposed.

Crafting such a joint rulemaking requires extensive coordination. We are working jointly with the Federal Reserve Board in consultation with the Justice Department. We have been impressed with the quality of the comments provided, and with the effort and expertise employed in the development of many of these comments.

An over-arching goal for our efforts has been to closely adhere to the statutory instructions provided to us by the Congress. The Act requires designation of payment systems that could be used in connection with unlawful internet gambling. Such a designation makes the payment system, and financial providers participating in the system, subject to the requirements of the regulations. The proposed rule designated the following 5 payment systems:

- Automated Clearing House Systems
- Card Systems (e.g., credit cards, debit cards, as well as stored value products)
- Check Collection Systems
- Money Transmitting Businesses
- Wire Transfer Systems (i.e., CHIPS)

The Act requires us to exempt certain restricted transactions or designated payment systems from any requirement imposed by the regulations if the Treasury Department and the Federal Reserve Board jointly determine that it is not reasonably practical for participants to prevent or prohibit unlawful internet gambling transactions. However, the proposed rule does propose to partially exempt certain participants within some of the designated payment systems from having to establish reasonably designed policies and procedures. The Treasury and the Federal Reserve Board determined that this was the most appropriate way to implement the Act while retaining fidelity to the intent of Congress.

Under the proposed rule, the gambling *business's* bank (or, if abroad, the first U.S. bank dealing with that bank) would not be exempted because it could, through reasonable due diligence, ascertain the nature of its customer's business and ensure that the customer relationship is not used to receive unlawful internet gambling transactions. The proposed exemptions generally extend to the gambler's bank. For example, in the case of checks, the check collection system is highly automated and it is not reasonably practical for the gambler's bank to know whether a check presented to it for payment involves unlawful internet gambling. However, the proposed rule provides that the gambling business's bank (or, if abroad, the first U.S. bank to receive the check) would need to have reasonably designed policies and procedures to prevent or prohibit unlawful internet gambling transactions involving these checks. In the situation where the bank of the gambling business is located abroad, the proposed requirements focus on the bank in the United States that has a corresponding relationship with the gambling business's bank.

The Act further requires us to provide nonexclusive examples of policies and procedures, which would be deemed "reasonably designed" to prevent or prohibit unlawful internet gambling transactions. As a result, this proposed rule contains a "safe harbor" provision, as mandated by the Act, that includes for each designated payment system nonexclusive examples of reasonably designed policies and procedures.

Conclusion

The Treasury, working closely and collaboratively with our colleagues at the Federal Reserve Board, is making progress in reaching our statutory mandate to promulgate a final rule that strictly adheres to the Act. No final decisions have been made regarding any aspect of the final rule or the comments provided, and we are still considering all aspects of the proposed rule. W hen we publish the final rule we will, of course, provide an analysis of the comments received, and the reasons for any decisions. We are committed to giving fair consideration to all relevant comments as we are working toward promulgation of a final rule. We have benefited from the knowledge and efforts of our colleagues at the Federal Reserve Board and the Justice Department, as we have proceeded in our consideration and analysis. Thank you, I would be happy to answer your questions.

-30-

April 2, 2008

Testimony of Wayne Abernathy

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Subcommittee on Domestic and International Monetary Policy

Committee on Financial Services

United States House of Representatives

Testimony of Wayne A. Abernathy

On Behalf of the American Bankers Association

Before the

Subcommittee on Domestic and International Monetary Policy

Committee on Financial Services

United States House of Representatives

April 2, 2008

Chairman Gutierrez, Ranking Member Paul, and members of the Subcommittee, my name is Wayne Abernathy, Executive Vice President, Financial Institutions Policy and Regulatory Affairs, of the American Bankers Association (ABA). ABA brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $12.7 trillion in assets and employ over 2 million men and women.

We appreciate the opportunity to comment on the Unlawful Internet Gambling Enforcement Act of 2006 (UIGEA) and the Prohibition on Funding of Unlawful Internet Gambling (Proposed Rule) issued recently by the Federal Reserve Board and the Department of the Treasury (Agencies). There is no question that prosecuting unlawful Internet gambling poses numerous law enforcement challenges. Therefore, during Congressional consideration of UIGEA, the ABA stated clearly that while we did not support the legislative proposal, if the Congress chose to proceed with legislation, care was needed to avoid applying burdensome unworkable regulation to insured depository institutions. Unfortunately, the statute as enacted and the regulations as proposed are both burdensome and unworkable and are unlikely to result in stopping illegal Internet gambling.

ABA members have invested enormous resources in fulfilling their obligation to report criminal or otherwise suspicious activity under the Bank Secrecy Act and anti-money laundering laws. These efforts to maintain the integrity of the financial system demonstrate that banks are dedicated partners in combating all forms of financial crime. But the UIGEA takes banks beyond the role of reporting ***potentially or allegedly*** illegitimate financial activity, and makes banks and

other financial institutions police, prosecutors, judges, and executing marshals in place of real law enforcement officers when it comes to one of the most elusive of modern crimes, namely, unlawful Internet gambling.

Banks are saddled with this exceptional burden, as stated in the UIGEA, "because traditional law enforcement mechanisms are often inadequate for enforcing gambling prohibitions or regulations on the Internet, especially where such gambling crosses State or national borders."[1] In other words, all the sophistication of the FBI, Secret Service, and other police computerized detection systems and investigative expertise devoted to fighting terrorism and financial crime are inadequate to the task of apprehending the unlawful gambling business or confiscating its revenues. ABA believes that punting this obligation to the banking industry and the other participants in the U.S. payment system is an unprecedented delegation of governmental responsibility with no prospect of practical success in exchange for the burden it imposes. Further, despite the hard work of the Treasury and the Federal Reserve to resolve issues raised by the statute, the Proposed Rule does not provide enough clarity in its definitions or overcome the limits of requiring foreign entities to abide by U.S. regulations.

While the Agencies have succeeded in addressing some of the issues raised by the UIGEA, the regulatory regime proposed would remain unworkable. Three fundamental issues would continue:

- The payments system is not an appropriate or effective enforcement tool.
- "Unlawful Internet gambling" is practically undefined in the Act, rendering prospects for success in controlling it unfavorable from the start. Regulation does not seem to fix this deficiency.
- It is virtually impossible to identify and stop cross-border payments that are not subject to U.S. law.

[1] 31 U.S.C. § 5361(a)(4)

The Payments System Is Not an Appropriate or Effective Enforcement Tool

The UIGEA requires that financial institutions play a major role in combating unwanted behavior, specifically unlawful Internet gambling. ABA members want to do their part to help fight financial crime. However, there are realistic limits to how ***the payments system*** can be used effectively to solve these problems.

The modern payments system is large, fast moving, and complex while at the same time responding to uncompromising demands for high levels of safety, security, and efficiency. It is constructed to facilitate payments from one entity to another as speedily and reliably as possible, and at low cost. It is no exaggeration to say that nearly all other economic activity in the nation in one way or another relies upon the payments system dependably fulfilling its function. It is one of the key infrastructures operating in the background that allow all of us to do what we do every day. The burdens placed upon financial institutions by the UIGEA and its implementing regulation would compromise the efficiency of the payments system, and yet there would be little reason to suppose that prohibited transactions would be effectively curtailed.

The Agencies recognized the challenges of using financial institutions to enforce the unlawful Internet gambling Proposed Rule, first of all, by exempting portions of check, Automated Clearing House (ACH), and wire transactions from the blocking requirements of the Act. Hundreds of millions of these payments are processed by banks ***every day***, and accounts are credited and debited automatically across the country. The Federal Reserve's most recent Payment Study reported that more that 93 billion payments were processed by financial institutions in 2006. These payment systems use bank routing numbers and individual account numbers to identify where the funds should be transmitted. The system does not take the names of account owners into consideration when moving funds in the automated programs. To do so would be impractical, given the demands for the efficiency, accuracy, and speed of payments. ABA appreciates that the Agencies recognize this fact.

Practical Barriers Remain for Non-exempt ACH, Check, and Wire Participants

Despite the partial exemption, the Proposed Rule still would impose on banks – those banks having direct commercial customer relationships to Internet gambling businesses – the obligation to establish policies and procedures to block ACH, check, and wire transfers involving unlawful

Internet gambling transactions. Unfortunately, this focus on the bank's relationship with its commercial customers falls short of resolving several remaining quandaries faced by those asked to implement the Act:

- Identifying commercial customers engaged in unlawful Internet gambling is difficult. It can be just as hard to identify those who are not so engaged. All commercial customers would be susceptible to being subjected to any screen, filter, and whatever other processes were developed in the effort to enforce the law. The major problem is that the effort almost entirely depends on information obtained from the customers, which are prone to be untruthful in the case of those seeking to avoid the restrictions of the law. That places a substantial investigative burden on banks that they are not well-equipped to meet. Banks could conduct extensive and intrusive initial inquiries of all companies with transactional websites to find out whether their businesses harbor prohibited gambling operations. The unscrupulous customer will likely find ways to evade discovery in such efforts, and legitimate customers will justly be offended and, at least at the margin, will find doing business with a bank less attractive. Even then, a clean bill of health means that the bank will next need to perform careful ***monitoring*** of transaction activity to detect suspect payments as indicators that the enterprise might have since become engaged in unlawful gambling contrary to its original account opening disclosures or promises. And since neither illegal Internet gambling enterprises nor their customers are likely to be upfront about their activities, it is more than likely that transaction monitoring will fail to catch most gambling payments.

- All of that, in turn, assumes that banks have a usable definition of "unlawful Internet gambling" to work with—something which neither the statute nor the regulations provide. Properly categorizing commercial customers operating Internet gambling businesses as unlawful gambling enterprises is severely complicated by the need to define which gambling businesses or activities are "unlawful." Instructing banks that they are on their own and should do their best is only a trap to catch banks that fail in this impossible task, not a means for stopping illegal Internet gambling.

- Even if one could distinguish between unlawful and lawful Internet gambling activities, segregating the two when they take place within the same commercial customer depends on

the customer's proper processing of its transactions to refrain from submitting the unlawful transactions with the legal—an effort that is sure to defy the bank's ability to monitor or audit.

Although banks have heavily invested in compliance programs to monitor customer acquisition and subsequent activity for suspicion of money laundering, terrorist financing or other financial crimes, the demands of UIGEA extend far beyond the normal capabilities of these Bank Secrecy Act (BSA) ***reporting*** processes. The Internet gambling legislation requires banks to do more than detect suspicious or unusual activity and report it to enforcement agencies for the decision by enforcement agencies about how to pursue the lead. In the UIGEA case, banks must make judgment calls from limited and probably conflicting information about what is unlawful under a complex legal structure of state and federal laws, evaluate the business activities of their commercial customers, and then intercept transactions or close customer accounts based on such judgments upon pain of regulatory penalties for non-compliance. By placing on banks the onus for actually interdicting unlawful Internet gambling transactions, rather than on government enforcement agencies and the court system, UIGEA imposes on banks, as they carry out their core duties to operate an efficient payments system, the impossible combined role of policeman, judge, jury, and enforcer.

Card System Participants Have Similar Barriers to Achieving UIGEA Compliance

The Proposed Rule does not exempt participants in card network transactions, including credit, debit, prepaid, and stored value cards. Both card issuers and merchant acquirers are ostensibly covered participants. Although the Agencies reason that the card networks are closed systems and merchants are granted entry to the system through a financial institution and can be tracked by the assigned merchant codes identifying their category of business, the reality is that the challenge of identifying offending transactions suffers from all the same pitfalls as have been enumerated for the other payment systems: Has an illegal gambling enterprise been accurately identified? Is the wagering involved "unlawful" in the relevant jurisdictions? Has a particular transaction been properly coded in a way that facilitates blocking? Have business lines, laws, customers, or other relevant factors changed since the last look?

A fundamental challenge is to ensure that Internet gambling businesses are identified as such and are assigned the correct ***merchant and transaction codes***. If an Internet gambling business is not accurately identified as to type of business when brought into the card network, then it will not be detectable by means of its code. Neither would transactions be captured by this method if an existing Internet business customer decides to start up a new gambling sideline. Such a business should, but very well may not, request a new code in view of its new line of gambling services. The Act and the Proposed Rule will only be effective with entities that do not hide their true business—all the while creating incentives for the unscrupulous to mask their gambling operations.

In addition, the transaction codes would have to differentiate between lawful and unlawful gambling transactions so that financial institutions could stop payments associated with prohibited activities. This challenge could prove insurmountable. If the card networks used the existing merchant code that has been developed for betting transactions (which includes lottery tickets, casino gaming, and off-track horse race betting), they would need to have more specific transaction codes to be assigned to different types of wagering since each type of betting may have its own structure of circumstances for when it is legal or illegal. For example, while it might be legal to use a credit card at the casino, it might be illegal to use it for the same wager over the Internet. Or, as another example, it may be legal to conduct an Internet wager of some type when all parties are in the same state (a lottery bet, perhaps) but not be legal across state lines. As a third example, while one form of gambling may be legal on the Internet or within a particular state, another may not be even if all parties are in the same state (such as sports gambling). Even if this were ***technically*** possible, implementation would be very complex and would still rely on the honesty and accuracy of the parties involved in the Internet gambling transaction—unlikely to be had in the case of illegal activities.

Even if a full range of codes could be established, it is still necessary to rely on an Internet gambling business to categorize its transactions accurately. Let us consider an example of a customer who places two separate bets, one lawful and one unlawful, paid for with a card. The amounts would have to be allocated to one merchant code and two separate transaction codes with two different authorizations and approvals. The Internet gambling business would be the one choosing whether to enter a transaction code where it would be approved or one that would be declined. If the gambling business is forced to choose between identifying a transaction as a horse

racing bet or a sporting event wager (for example), the odds are that it will ***not*** choose the clearly unlawful bet – on the sporting event – to avoid causing the transaction to be declined.

The next challenge is the creation of an effective system used by the card issuing bank to determine if it should approve a gambling transaction. According to the Proposed Rule, the financial institution is allowed to rely on the policies and procedures established by the network in this regard. For example, an issuing bank receives a request for authorization for a card transaction initiated by one of its customers at an entity with an Internet gambling merchant code and a transaction code indicating a horse racing wager. The bank, under the Proposed Rule, may rely upon those codes as being accurate, but the bank still must have a system in place to accept or reject the transaction. The same situation would hold for payments for lottery sales, sports wagering, poker payments, and any other type of transaction code associated with betting. Once identifying a transaction as a form of gambling, the bank must make an informed decision on whether the transaction constitutes "unlawful" gambling. Alternatively, while the law does not require it, the bank could choose to decline all transactions from Internet gambling businesses and risk "over blocking" some payments, that is risk blocking payments that either are not gambling or are not "unlawful gambling." This regulatory overkill and erosion in the quality of payments services from the bank may be the only safe avenue for the bank to follow to avoid a noncompliance problem with the statute. Customers would then have to seek alternative payments system avenues for their transactions not made illegal by the Act but rendered too risky for the bank to handle.

Although the Proposed Rule only requires policies and procedures to identify and block transactions related to unlawful Internet gambling, a "safe harbor" is provided for financial institutions to block a transaction if (1) the transaction is restricted; (2) such a person reasonably believes the transaction to be restricted; or (3) the person is a participant in a payment system and blocks a transaction relying on the policies and procedures of that payment system in an effort to comply with the regulation. Some payment system operators and many banks have stated that they do not process any gambling transactions at all. ABA believes the "safe harbor" provision should be strengthened by recognizing the right of financial institutions to block all gambling related transactions for their own reasons or discretion. We concur in the Agencies' belief that "… the Act does not provide the Agencies with the authority to require designated payment systems or participants in the systems to process ***any*** gambling transactions, including those transactions excluded from the Act's definition of unlawful Internet gambling, if a system or participant ***decides***

for business reasons not to process such transactions."[2] [Emphasis added.] We have urged the Agencies to include this essential discretionary option expressly within the breadth of the Proposed Rule's so-called safe harbor or over blocking section.

While it may be tempting to seek to block undesirable behavior by exploring the restrictions on closed payments networks such as those used for debit and credit cards, ultimate success is likely to remain elusive. It is reasonable to expect that Internet gambling enterprises will be working to overcome any card payment restrictions meant to halt payments. In the meanwhile, banks will expend enormous resources on sophisticated efforts with no real hope of effectiveness. ABA believes that UIGEA, even with the commendable efforts by the Agencies to make it workable through the Proposed Rule, condemns the banking industry to a Sisyphean exercise that is more likely to catch banks in a compliance trap than it will stop gambling enterprises from profiting on illegal wagering. In the process, the efficiency of the payments system, vital to nearly all in our nation, is likely to be harmed.

"Unlawful Internet Gambling" is Practically Undefined in the Act and Regulation Does Not Fix This Deficiency

ABA believes that the flaws in the definition of "unlawful Internet gambling" are fatal to this proposal as a legal, policy, and practical matter. What banks are required to do under the Act relates to and is derived from actions that constitute "unlawful Internet gambling." It is the reference point from which all bearings are to be taken. A unified, practically workable definition of "unlawful Internet gambling" must be included in either the statute or in the implementing regulations. Without such a clear reference point it is impossible for banks to know where to land for a successful implementation of the statute. Moreover, given its central role, an appropriate definition of "unlawful Internet gambling" would require at the least a re-proposal of implementing regulations.

To begin with, "unlawful Internet gambling" is too vague a term by itself to be operationally useful. As drafted, § ___ 2(t) of the Proposed Rule does not narrow the uncertain breadth of the term as used in the Act. This means that the regulation retains all of the complicated problems in the

[2] 72 Federal Register at 56688, October 4, 2007.

statute regarding what is unlawful versus what is lawful Internet gambling. These include such issues as who (minors, residents, insiders, public officials, licensed or unlicensed operators, convicted felons) is engaging in what conduct (games of chance, amateur sports, professional sports, horse racing, dog racing, lotteries, and so forth), where (on location, in the same state, across state lines, across international boundaries, in the air, on rivers or at sea, on reservations, and so forth), and when (after hours, Sundays, holidays, before or during events being wagered on). In addition, all the basic proof problems that have plagued law enforcement prosecution are passed along under this proposed program to the participants in the payments system. All of the hurdles that the Agencies have identified in connection with a government obligation to create a list of unlawful Internet gambling businesses are left to each and every U.S. bank individually to clear, including "ensur[ing] that the particular business was, in fact, engaged in activities deemed to be unlawful Internet gambling…requir[ing] significant investigation and legal analysis … complicated by the fact that the legality of a particular Internet gambling transaction might change depending on the location of the gambler at the time the transaction was initiated, and the location where the bet or wager was received."[3]

The regulations, not specifying which ttansactions qualify as "unlawful Internet gambling," point those affected by the law to "underlying substantive State and Federal gambling laws and not… a general regulatory definition" to determine the scope of what unlawful Internet gambling comprises. This is a judicial function that banks are not qualified to fill. Requiring banks to be arbiters of the actions of individuals and businesses with regard to the interaction of gambling laws for all states, as well as federal gambling laws, is infeasible and would place a crippling processing burden and unbounded litigation risk on the nation's payments system participants. The vagaries of what constitutes "unlawful Internet gambling" cannot be resolved by passing the burden on to the banking industry.

Nevertheless, the definition of "unlawful Internet gambling" is pivotal to the operation of the statute and the Proposed Rule. As another example, without a workable definition of "unlawful Internet gambling," it is impossible to determine what constitutes an "unlawful Internet gambling ***business***" [emphasis added] for purposes of determining the customer relationship. This deficiency goes to the heart of the compliance process; if it is impossible to determine what an "unlawful

[3] 72 Federal Register at 56690, October 4, 2007.

Internet gambling business" is, it is impossible to determine which bank possesses the customer relationship with such business and the associated duties that come with that customer relationship.

It is one thing for banks to report suspicious activity based on their judgment of the possibility of potential illegal conduct; it is quite another to require a bank to act on its own judgment about legality and to impose sanctions for such *ex parte* determinations. While ABA believes banks and other payments system participants must retain the operational flexibility to refuse any gambling or otherwise uncertain transactions for compliance or business reasons, and without legal liability for doing so, such latitude for voluntary business judgment is quite a different thing from a government mandate to deny payments services based on a set of facts that a bank is not well constituted to prove or to investigate, viewed in the context of complex and changing legal standards that a bank is not in a position to interpret. In effect, the Act and the Proposed Rule would establish a law enforcement regime resting on a program of private sector decree. The banking industry understandably shies away from that role.

Would a Government List of Unlawful Internet Gambling Businesses Solve the Definition Problem?

Although the option of a government list of unlawful gambling businesses was not included in the Proposed Rule, the Agencies asked for comment on whether government maintenance of such a list is appropriate. Establishing and maintaining a sanction list presents challenges. However, given the lingering problem of an impossibly vague definition of "unlawful Internet gambling," ABA believes that a government generated list could have potential merit, but only if certain essential conditions are met and so long as depository institutions are absolved from other requirements intended to block unlawful gambling transactions.

Of course, ownership and upkeep responsibilities for such a list cannot and must not fall on financial institutions. Identifying the targets for such sanctions is a law enforcement role, and shifting it to banks would involve banks in the same definitional and judgment dilemmas identified above. Moreover, there is no way that any one bank would have broad enough information to develop a list comprehensive enough to be useful. Rather, it is the federal government that has the authority and experience in implementing sanction programs, as exemplified by the programs managed by the Treasury Department's Office of Foreign Assets Control.

ABA stresses that in connection with consideration of establishing such a sanctions list, the scope of the list should occupy at least a functionally comprehensive segment of the payments system. The list must be definitive, not illustrative. For instance, a list that leaves to banks an obligation to bar transactions with entities ***not on the list*** under additional circumstances would be of very little value.

Any such a list must also meet the following essential conditions:

- The listed names would be searched only against data fields normally recorded in connection with the payment method;
- Participants would not have any further identifying or blocking obligations beyond the list with respect to the set of designated payments;
- Reasonable policies and procedures for the designated payments would be deemed compliant if limited to verifying customers against the list and blocking only covered transactions with those listed customers; and
- Any list would contain only commercial customers (and not individual gamblers).

It is Virtually Impossible to Identify and Stop Cross-border Payments That are Not Subject to U.S. Law

ABA believes that while well-intentioned, the Agencies' efforts at cross-border implementation by requiring U.S. participants to engage foreign correspondent banks in identifying and blocking unlawful Internet gambling-related transactions raises more problems than it solves.

First, for the reasons recited earlier, U.S. participants have none of the system capabilities that enable them to identify and block restricted transactions conducted vis-à-vis ACH, checks, or wire transfers when they are not the bank with the customer relationship with the Internet gambling business.

Second, the Proposed Rule relies on an implicit assumption that the correspondent relationship among banks executing gambling transactions parallels the relationship among banks monitoring for money laundering transactions. This assumption is not warranted. International standards for anti-money laundering and counter terrorism financing controls have been adopted in nearly all international jurisdictions. Not only are there no similar international control standards for

Internet gambling transactions, there is broad international resistance to such controls. Consequently, there is little basis upon which a U.S. and a foreign correspondent could practically agree to implement effective controls to block unlawful cross-border gambling transactions. Indeed, we cannot dismiss the possibility that too much pressure in this area on foreign counterparts could compromise cooperation with anti-money laundering efforts.

Third, the levels of corresponding relationships between the foreign correspondent (that has direct dealings with a U.S. participant) and the ultimate foreign bank that has the gambling business customer relationship may have several intermediate levels. This nesting defies any realistic expectation that a contractual agreement between the U.S. bank and its immediate foreign counterparty will effectively screen out "unlawful Internet gambling" transactions initiated by U.S. gamblers with commercial customers of foreign banks in off-shore jurisdictions.

Fourth, the cross-border system proposed is dependent on a foreign bank's unlikely ability to distinguish what is or is not "unlawful" Internet gambling in any of the 50 United States and therefore be in a position to comply with any contractual undertakings with U.S. payment system participants. Why should we expect a foreign bank to be more successful than its U.S. counterpart in unraveling the mystery of the definition of "unlawful" Internet gambling?

Fifth, the proposal fails to consider the issue of when a foreign correspondent's home country expressly prohibits it from having policies and procedures required by the Proposed Rule or cooperating in its enforcement. For instance, if a British bank has policies and procedures to identify and block transactions which qualify as "unlawful Internet gambling" in the U.S., but these same transactions are legal in the U.K., the bank could be subject to litigation or enforcement actions in its home country. Some foreign correspondent banks may be prohibited by their home country laws from adopting policies and procedures to identify such transactions. Furthermore, if a foreign correspondent bank fails to comply with the Proposed Rule, the remedial action of blocking its access to the U.S. payments systems, as provided in § ___.6, seems to be a rather harsh penalty with little likely offsetting benefit. Exposing foreign correspondent banks to such risks seems an unacceptable byproduct of the Proposed Rule, especially since the institutions likely to be affected are not located in the United States.

Conclusion

The UIGEA relies on financial institutions to enforce the law where federal agents could not. The Proposed Rule recognizes the inadequacy of using the payments system as a law enforcement tool in certain circumstances by exempting some types of payments. Moreover, to be effective, it relies primarily on Internet gambling businesses to commit to an "honor system" whereby they would voluntarily identify themselves to credit card networks to deny themselves payments. This is not a realistic expectation.

The intent of the UIGEA, and the Proposed Rule, is to block unlawful Internet gambling, but there is no clear definition of what constitutes unlawful Internet gambling. Banks would be required to institute policies and procedures to block these unlawful transactions without being sure of what they should be blocking to and from whom. This is not a reasonable undertaking.

The cross-border provisions of the UIGEA and the Proposed Rule require financial institutions in the United States to rely on foreign correspondent banks to interpret and enforce the UIGEA even though domestic banks consider it a daunting challenge considering the current lack of clarity and guidance. This is not a feasible requirement.

The UIGEA and the Proposed Rule do not provide a rational path towards halting unlawful Internet gambling. The path leads to an increased cost and administrative burden to the banks and an erosion in the performance of the payments system, but it will not result in stopping illegal Internet gambling transactions. Imposing this enormous unfunded law enforcement mandate on banks in place of the government's law enforcement agencies is not likely to be a successful public policy.

Testimony of

Ted Teruo Kitada
Senior Company Counsel
Legal Group
Wells Fargo & Company

Before the

Subcommittee on Domestic & International
Monetary Policy, Trade, and Technology

Committee On Financial Services

United States House of Representatives

April 2, 2008

Thank you, Chairman Gutierrez, Ranking Member Paul, and members of the Committee for this opportunity to testify today regarding the Unlawful Internet Gambling Enforcement Act of 2006 and proposed regulations under this act.

I. Introduction. In enacting the Unlawful Internet Gambling Enforcement Act of 2006 (the "Act"),[1] Congress endeavored to address certain identified problems associated with unlawful Internet gambling.[2] In order to address these problems, the Act prohibits any person engaged in the business of betting or wagering from knowingly accepting payments in connection with the participation of another person in unlawful Internet gambling. These payment transactions are termed "restricted transactions."[3]

On October 4, 2007, the Board of Governors of the Federal Reserve System and The Departmental Offices of the Department of the Treasury (collectively, the "Agencies") published a notice of joint proposed rule making and request for comment in the Federal Register[4] (the "Proposal" or "proposed regulations," as applicable) to implement applicable provisions of the Act. As required under the Act, the Proposal designates certain payment systems that could be used in connection with unlawful Internet gambling transactions prohibited under the Act. The Proposal requires participants in designated payment systems to establish policies and procedures reasonably designed to identify and block, or otherwise prevent or prohibit, transactions in connection with unlawful Internet gambling. The Proposal also grants exemptions to

[1] Pub.L.No. 109-347, 120 Stat. 1884 (codified at 31 U.S.C. §§ 5361-5367). The Act was signed into law on October 13, 2006.
[2] See also H.R. 2046, 110th Cong. (2008) for other identified problems with Internet gambling in addition to those identified in the Act.
[3] 31 U.S.C. § 5362(7).
[4] Prohibition on Funding of Unlawful Internet Gambling, 72 Fed.Reg. 56680 (proposed October 4, 2007), to be codified at 12 C.F.R. Part 233 and 31 C.F.R. Part 132.

certain participants in designated payment systems from the requirements to establish such policies and procedures because the Agencies believe that it is not reasonably practical for those exempted participants to identify and block, or otherwise prevent or prohibit, unlawful Internet gambling transactions restricted by the Act. Finally, the Proposal describes the types of policies and procedures that nonexempt participants in each class of designated payment systems may adopt in order to comply with the Act, including nonexclusive examples of policies and procedures which would be deemed to be reasonably designed to prevent or prohibit unlawful Internet gambling transactions proscribed by the Act.

II. Some significant issues for the financial services industry, including Wells Fargo. In reviewing the proposed regulations and the Act, Wells Fargo has identified certain key issues as set forth in its comment letter, dated December 12, 2007, copy attached. We would briefly like to highlight some of them for the committee:

A. The definition of "unlawful Internet gambling." While this term is a core definition under the Act, "unlawful Internet gambling" is not clearly defined.[5] In the Proposal, this term is defined as placing, receiving, or transmitting a bet or wager by means that involves the use of the Internet "where such bet or wager is unlawful under any applicable Federal or State law in the State or Tribal lands in which the bet or wager is initiated, received, or otherwise made."[6] In short, by merely referencing applicable federal or state law, Congress in effect has passed the obligation of identifying unlawful Internet activities to the financial services industry, the principal participants in the payment systems. That industry is tasked with the unenviable burden of determining if a

[5] 31 U.S.C. § 5362(10).
[6] 72 Fed.Reg. at 56697; § __.2(t).

business activity of a customer encroaches upon unlawful Internet gambling activity. This burden is further compounded for a financial service provider with a retail presence in 50 states, such as Wells Fargo. Wells Fargo must identify, interpret, and apply the state laws in all 50 states to prevent or prohibit unlawful Internet activities, in addition to federal law.

To mitigate this burden, we have urged that the Agencies define the term "unlawful Internet gambling" with greater precision. In the event the Agencies are unable to draw the definition with more precision, we have urged the Agencies to expand and broaden the exemptions to include all participants in the automated clearing house ("ACH") system, the check collection system, and the wire transfer system.

To substantiate our view that these three payment systems should be exempted under the Proposal, we provide some sense of the sheer number of transactions Wells Fargo may be required to monitor, review, and block in these three payment systems, as follows:

- **ACH system.** As an originating depository financial institution ("ODFI") with responsibility under the Proposal to identify restricted ACH debit transactions, we originate in excess of approximately 3.1 million debit transactions daily. As a receiving depository financial institution ("RDFI") with responsibility to identify restricted ACH credit transactions, we receive approximately 1.2 million credit entries daily. In sum, in ACH transactions alone, we would on a daily basis need to deal with over 4.3 million transactions.

- **Check collection system.** As a depository financial institution, we handle for forward collection approximately 11 million checks daily, with approximately 6 million of such checks drawn on third party financial institutions.
- **Wire transfer system.** As a beneficiary's bank of wire transfers with responsibility to prevent restricted transactions, we receive daily approximately 25,000 to 30,000 incoming wire transfers. As an originator's bank or intermediary bank sending a wire transfer directly to a foreign bank, with the responsibility to deny access to such bank as to restricted transactions, we send approximately 5,000 to 6,000 such wires daily. We would, in short, be required to review these numerous wire transfer transactions daily.

These foregoing numbers should provide some sense of the high volume of transactions we process daily. To oversee these payment systems to identify restricted transactions is a significant and difficult mission.

If the Agencies are unable to draw a clearer definition of the term and if the Agencies do not have an appetite to exclude the three enumerated payment systems, we have urged the Agencies to consider a government generated list in some form, even if the list may have limited utility.

B. Applicability of the proposed regulations to existing customers. While the Proposal is not entirely clear, we are gravely concerned that the final regulations to be issued by the Agencies under the Act may apply to existing customers as of the effective date of the final regulations. If the Agencies contemplate the application of the final regulations to existing customers as of the effective date, we confront significant burdens in complying with the final regulations.

Due diligence would need to be undertaken as to existing customers to confirm the nature and scope of their business activities, to determine whether they are engaged in restricted transactions. We currently have over 24 million consumer customers and 1.8 million business customers. While we are familiar with the nature of the business activities of many of these customers due to the due diligence under the regulations issued under § 326 of the USA PATRIOT Act, effective as of October 1, 2003,[7] many of our customers predate these regulations. Consequently, these customers may not have been subjected to the more robust due diligence process evidenced in these regulations.

Agreements with existing customers would have to be amended to incorporate provisions advanced in the Proposal. For example, under § __.6(c)(1)(ii), the proposed regulations set forth examples of policies and procedures reasonably designed to prevent or prohibit restricted transactions in card systems. In this regard, the proposed regulations provide that such policies and procedures are deemed to be so reasonably designed if they include as a term of the merchant customer agreement that the merchant may not receive restricted transactions through the card system. Wells Fargo has a significant number of merchant customers, totaling approximately 140,000. If Wells Fargo seeks to provide such a provision prohibiting the receipt of restricted transactions in the merchant customer agreement as to existing merchant customers, it would face a significant administrative and operational challenge timely amending existing agreements, if the final regulations were applied retroactively.

While the originator's bank and intermediary bank sending a wire transfer are generally exempt from the requirements for establishing written policies and procedures

[7] 31 C.F.R. § 103.120, *et seq.*; 68 Fed.Reg. 25090 (May 9, 2003).

reasonably designed to prevent or prohibit restricted transactions,[8] an originator's bank or intermediary bank sending a wire transfer directly to a foreign bank are nevertheless required to have policies and procedures reasonably designed to identify and block, or otherwise prevent or prohibit, restricted transactions.[9] Policies and procedures deemed to be reasonably designed must include instances when wire transfer services should be denied and circumstances under which the correspondent account should be closed "... with respect to a foreign bank that is found to have received from the originator's bank or intermediary bank wire transfers that are restricted transactions ...."[10] The right to block wire transfer transactions and close foreign correspondent accounts is plainly matters to be addressed in foreign correspondent banking agreements. Inasmuch as such rights are not currently addressed in such agreements, we would need to adopt amendments thereto with over 200 foreign correspondent banks. We are confident that committee members can well appreciate the hardship we would confront in seeking adoption of such amendments with foreign banks.

III. Conclusion. These observations conclude my remarks. I am pleased to respond to any questions the committee may have. Thank you for this opportunity to speak before this committee.

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[8] § __.4(c)(2).
[9] § __. 6(f)(2).
[10] *Ibid.*

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Ted Teruo Kitada
Senior Company Counsel

Law Department
MAC A0194-253
45 Fremont Street, 26th Floor
San Francisco, CA 94105
415 396-5461
415 975-7865 Fax
kitadat@wellsfargo.com

(415) 396-5461

December 12, 2007

By Facsimile and First Class U.S. Mail
202.452.3819

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

Re: Prohibition of Funding of Unlawful Internet Gambling, Docket No. R-1298

Dear Ms. Johnson:

Wells Fargo & Company (NYSE: WFC) is a diversified financial services company providing banking, insurance, investments, mortgage, and consumer finance to nearly 11 million households and 23 million customers through 5,928 banking offices, the Internet ("wellsfargo.com"), and other distribution channels throughout North America, including all 50 states, and the international marketplace. Wells Fargo & Company has over $549 billion in assets and 158,800 employees, as of September 30, 2007. Wells Fargo & Company ranked fifth in assets and fourth in market value of its stock among its peers as of such date. Wells Fargo & Company is the 25th largest private employer in the United States. Wells Fargo & Company has the highest possible credit rating, "Aaa," from Moody's Investors Service and the highest credit rating given to a U.S. bank, "AA+," Standard and Poor's Ratings Services.

Wells Fargo & Company is pleased to submit its comments on the captioned matter. The comments below relate primarily to the payment activities of Wells Fargo & Company's principal banking subsidiary, Wells Fargo Bank, National Association ("Wells Fargo").

I. Background. On October 4, 2007, the Board of Governors of the Federal Reserve System and The Departmental Offices of the Department of the Treasury (collectively, the "Agencies") published a notice of joint proposed rule making and request for comment in the Federal Register[1] (the "Proposal" or "proposed regulations," as applicable) to implement

[1] Prohibition on Funding of Unlawful Internet Gambling, 72 Fed.Reg. 56680 (proposed October 4, 2007), to be codified at 12 C.F.R. Part 233 and 31 C.F.R. Part 132.

applicable provisions of the Unlawful Internet Gambling Enforcement Act of 2006[2] (the "Act"). As required under the Act, the Proposal designates certain payment systems that could be used in connection with unlawful Internet gambling transactions prohibited under the Act. The Proposal requires participants in designated payment systems to establish policies and procedures reasonably designed to identify and block or otherwise prevent or prohibit transactions in connection with unlawful Internet gambling. The Proposal also grants exemptions to certain participants in designated payment systems from the requirements to establish such policies and procedures because the Agencies believe that it is not reasonably practical for those exempted participants to identify and block, or otherwise prevent or prohibit, unlawful Internet gambling transactions restricted by the Act. Finally, the Proposal describes the types of policies and procedures that nonexempt participants in each class of designated payment systems may adopt in order to comply with the Act, including nonexclusive examples of policies and procedures which would be deemed to be reasonably designed to prevent or prohibit unlawful Internet gambling transactions proscribed by the Act.

II. Wells Fargo's comments specifically solicited under the Proposal. We respectfully offer the following comments relative to the Proposal. In submitting our comments, we shall initially address in the order set forth therein those subjects for which the Agencies solicits specific comments therein.

A. Six month implementation period. The Agencies propose that final regulations take effect six months after the joint final rules are published.[3] The Agencies ask whether this six-month period is reasonable. In that regard, the Agencies request that commenters supporting a shorter period should explain the reasons they believe payment system participants would be able to modify their policies and procedures, as required, in the shorter period. Conversely, the Agencies ask that commenters requesting a longer period should explain the reasons the longer period would be necessary to comply with the final regulations, particularly if the need for additional time is based on any system or software changes required to comply with the final regulations.

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[2] Pub.L.No. 109-347, 120 Stat. 1884 (codified at 31 U.S.C. §§ 5361-5367). The Act was signed into law on October 13, 2006.
[3] 72 Fed.Reg. at 56682.

We object to the proposed six-month implementation period. We provide our reasoning to this objection, as follows:

- Subsection __.5(a) of the proposed regulations expressly requires all nonexempt participants in the designated payment systems to establish and implement policies and procedures in order to identify and block, or otherwise prevent or prohibit, restricted transactions. In accordance with the Act,[4] § __.5(b) provides that a participant in a designated payment system shall be considered in compliance with this requirement if the designated payment system of which it is a participant has established policies and procedures to identify and block, or otherwise prevent or prohibit, restricted transactions and the participant relies on, and complies with, such policies and procedures.[5] As a practical matter, based on our experience in dealing with multiple regional and national payment systems the designated payment systems will not be able to issue such policies and procedures until the final regulations are published by the Agencies. Even after the designated payment systems issue such policies and procedures, participants in such designated payment systems will require a reasonable period of time after the finalization of the designated payment system's policies and procedures to adopt and implement a process to conform to such policies and procedures. While the practice of payment systems may vary, many of these payment systems may issue for comment by participants in the systems proposed policies and procedures under the final regulations. In response to comments, the policies and procedures may be redrawn or amended thereafter. Based on these observations, the issuance of policies and procedures by payment systems, such as local and national clearing houses, involves a considerable amount of time and effort. Further, in order for participants to exploit this compliance safe harbor, participants themselves will require additional time to develop and issue their own process to conform to such policies and procedures, especially for those participants having significant, complex regional or national operations, such as ourselves.

[4] 31 U.S.C. § 5364(c).
[5] 72 Fed.Reg. at 56697-56698.

- In connection with the foregoing, the final regulations should anticipate that policies and procedures issued by designated payment systems will be amended or modified from time to time. For those participants relying in good faith on such policies and procedures for the compliance safe harbor, the final regulations should grant a commercially reasonable period of time for participants to conform their policies and procedures to such amendments or modifications. During such amendment or modification period, the participants should continue to enjoy the compliance safe harbor granted under § __.5(b).
- We are unclear as to whether the final regulations to be issued by the Agencies under the Act will apply to existing customers as of the effective date of the final regulations. If the Agencies contemplate the application of the final regulations to existing customers, participants will require a significant period of time to implement the final regulations. Due diligence would need to be undertaken as to existing customers to confirm their activities. Agreements with existing customers would have to be amended to incorporate provisions advanced in the Proposal. For example, under § __.6(c)(1)(ii), the proposed regulations set forth examples of policies and procedures reasonably designed to prevent or prohibit restricted transactions in card systems. In this regard, the proposed regulations provide that such policies and procedures are deemed to be so reasonably designed if they include as a term of the merchant customer agreement that the merchant may not receive restricted transactions through the card system. Wells Fargo has a significant number of merchant customers, totaling currently in the low six figures. If Wells Fargo seeks to provide such a provision prohibiting the receipt of restricted transactions in the merchant customer agreement as to existing merchant customers, it would face a significant administrative and operational challenge timely amending existing agreements, if the final regulations were applied retroactively.

Based on the foregoing, we urge a longer period to comply with the final regulations. The enhancements to our systems and software will be highlighted below as we respond to the specific comments solicited in the Proposal. Further, the training and educating of our bankers to implement the new policies and procedures and to operate the enhanced systems will require

additional time, as we have numerous lines of business and products and services that will be directly impacted by these mandated policies and procedures. Additionally, to the extent we wish to rely on the compliance safe harbor through relying on, and complying with, the policies and procedures of designated payment systems, the process to conform to such policies and procedures will require significant time to develop and issue.

Accordingly, we strongly recommend the final regulations take effect no less than 24 months after they are published.

B. The terms and definitions. The Agencies request comment on all of the terms and definitions set forth in the Proposal.[6] In particular, the Agencies seek comment on any term used in the Proposal that a commenter believes are not sufficiently understood or defined.

One of the core deficiencies in the Proposal is the failure to define clearly the meaning of the term "unlawful Internet gambling."[7] In the Proposal, this term is defined as placing, receiving, or transmitting a bet or wager by means that involves the use of the Internet "where such bet or wager is unlawful under any applicable Federal or State law in the State or Tribal lands in which the bet or wager is initiated, received or otherwise made."[8]

The Agencies apparently did not refine this definition because

> [t]he Act focuses on payment transactions and relies on prohibitions on gambling contained in other statutes .... Further, application of some of the terms used in the Act may depend significantly on the facts of specific transactions and could vary according to the location of the particular parties to the transaction based on other factors unique to an individual transaction.[9]

Due to the absence of a clear meaning to this key term under both the Act and the Proposal, financial institutions are required at their peril to determine unilaterally which state or federal laws governing gambling apply to a particular transaction or a set of transactions. This undertaking may be challenging and burdensome to financial institutions attempting in good faith to conform to the final regulations.

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[6] 72 Fed.Reg. at 56683.
[7] 72. Fed. Reg. at 56697; § __2(i).
[8] *Ibid.*
[9] 72 Fed.Reg. at 56682.

For instance, under the California Penal Code, a raffle ticket may not be sold, traded, or redeemed over the Internet.[10] However, if a purchaser of a raffle ticket online is located physically in a remote jurisdiction outside of California where the purchase of raffle tickets online is lawful, a financial institution may be unable to differentiate "reasonably"[11] as a practical matter between lawful and unlawful transactions, particularly by automated means, given the volume of transactions a financial institution may process. Thus, e.g., a financial institution may at its peril improperly block an online raffle ticket sale transaction by a seller located in California because the purchaser is located in a venue where such raffle ticket sale is lawful (assuming that the laws of that venue govern the transaction). This challenge is further compounded by the Proposal providing it is not intended to restrict lawful gambling activities.[12]

This transaction identification difficulty is further increased by the challenge the financial institutions confront in identifying the businesses themselves engaged in apparently unlawful Internet gambling. Certainly, the Agencies openly acknowledge this difficulty by electing not to provide a list of such unlawful Internet gambling businesses due to "significant investigation and legal analysis."[13] Presumably, the financial institutions are saddled with the burden of undertaking such significant investigation and legal analysis.

Further, the Proposal notes that (as detailed above) "such analysis could be complicated by the fact that the legality of a particular Internet transaction might change depending on the location of the gambler at the time the transaction was initiated, and the location where the bet or wager was received."[14]

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[10] California Penal Code § 320.5(f) provides:

> (f) No raffle otherwise permitted under this section may be conducted, nor may tickets for a raffle be sold, within an operating satellite wagering facility or racetrack enclosure licensed pursuant to the Horse Racing Law (Chapter 4 (commencing with Section 19400) of Division 8 of the Business and Professions Code) or within a gambling establishment licensed pursuant to the Gambling Control Act (Chapter 5 (commencing with Section 19800) of Division 8 of the Business and Professions Code). A raffle may not be advertised, operated, or conducted in any manner over the Internet, nor may raffle tickets be sold, traded, or redeemed over the Internet. For purposes of this section, advertisement shall not be defined to include the announcement of a raffle on the Web site of the organization responsible for conducting the raffle. (Emphasis supplied.)

[11] See § __.5(c) of the Proposal, 72 Fed.Reg. at 56697: "Such person reasonably believes the transaction to be a restricted transaction; ...."

[12] See § __.5(d) of the Proposal, 72 Fed.Reg. at 56698.

[13] 72 Fed.Reg. at 56690.

[14] *Ibid.*

To further make this identification of the unlawful enterprise more difficult, a business may have both unlawful activities proscribed by the Act and lawful activities not proscribed by the Act. A gaming business may operate a lawful restaurant or gift shop. A payment through a designated payment system may be intended for the lawful line of business. Through the course of time, a business may also change its activities. Formerly lawful activities may evolve into unlawful activities.

We regret that we cannot offer at this stage any further input on the inherent ambiguity of the term "unlawful Internet gambling," except to note that this is a highly problematical shortcoming in the Proposal. We comment below further on this issue, specifically to the development of a list.

In regard further to the definitions in the Proposal, while not specifically defined, we are troubled by the repeated use of the term "block" therein. This term is unclear. Do the Agencies suggest that a participant has an obligation to "freeze" accounts and perhaps even to debit accounts involved in restricted transactions through the selection of this term in the Proposal? We suggest that the term "block" be struck so that, where applicable, the following is set forth in the final rules: "policies and procedures to identify and prevent or prohibit restricted transactions ...."

C. List of designated payment systems. The Agencies request comment on whether the list of designated payment systems in the Proposal is too broad or narrow. Particularly, the Agencies request comment on whether nontraditional or emerging payments systems could be used in connection with, or to facilitate, any restricted Internet transaction. In the event a commenter believes that such a payment system should be so designated in the final rule, the commenter should prescribe policies and procedures that might be reasonably designed to identify and block, or otherwise prevent or prohibit, restricted transactions through that system.[15]

Firstly, we believe that the designated payment systems are too broad. We recommend that the Agencies exclude the Automated Clearing House ("ACH") system (at least as to domestic ACH transactions), the check collection system, and the wire transfer system categorically as designated payment systems under the Proposal. While we are mindful that the Agencies may

[15] 72 Fed.Reg. at 56685.

have some reservations about excluding these three payment systems from coverage, let us generally explore the merits we have identified for this position.

Currently, the state of the technological art supporting these three payment systems is such that apparent restricted transactions may not be identified by automated means (even if we can achieve an understanding of the meaning of this term "restricted transactions"). Because we cannot by automated means identify restricted transactions, we will in all likelihood identify customers engaged in risky behavior related to restricted transactions (e.g., gambling businesses generally) and block or prevent many transactions benefiting such customers, regardless of the lawful or unlawful nature of the underlying behavior causing the transactions to originate. In short, the compliance efforts under the final regulations will likely be largely customer-centered rather than transaction-centered. When the compliance effort focuses on the customer vis-à-vis the transaction, one significant, unintended consequence will be the limiting or closing of access to these payment systems to many businesses engaged in lawful activity merely because such businesses may be viewed by financial institutions as engaged in activities that are deemed "risky." Due to such activities, financial institutions will approach such businesses with an enhanced or elevated sense of risk, resulting in the creation of an unbanked or underbanked population of businesses currently enjoying unencumbered access to these payment systems through financial institutions. The Act clearly did not intend this result.[16]

Further to this analysis advocating the exclusion of such payment systems, let us delve into the ACH payment system to highlight this view. The Proposal grants an exemption from the proposed regulation's requirements for the ACH system operator, the originating depository financial institution ("ODFI") in an ACH credit transaction, and the receiving financial depository institution ("RDFI") in an ACH debit transaction (except with respect to certain cross-border transactions).[17] The Proposal does not exempt the financial institution serving as the ODFI in an ACH debit transaction or the RDFI serving in an ACH credit transaction because the Proposal advances an excessively sanguine thesis: these institutions typically have a pre-existing relationship with the customer receiving the proceeds of the ACH transaction, and could, with reasonable due diligence, take steps to ascertain the nature of the customer's business

[16] See 31 U.S.C. § 5364(b)(4).
[17] 72 Fed.Reg. at 56686.

and ensure that the customer relationship is not used to receive the proceeds of restricted transactions.

Our comment is directed to one of the key, core flaws in the Proposal, as initially observed above, a flaw adversely impacting the three payment systems for which we seek exclusion. (The following comment could apply to other requirements under the Proposal.) While state or federal laws may provide some guidance on the nature of unlawful Internet gambling activities, financial institutions may have great difficulty in identifying whether a particular customer is engaged in such unlawful activities. (This difficulty is compounded by the sheer volume of transactions we process daily.[18])

This difficulty financial institutions face is made plain by footnote number one to the Proposal.[19]

The Act grants exemptions to three general categories of transactions:

- Intrastate transactions (a bet or wager made exclusively within a single state, whose state law or regulation contains certain safeguards regarding such transactions and expressly authorizes the bet or wager and the method by which the bet or wager is made, and which does not violate any provision of applicable federal gaming statutes).
- Intratribal transactions (a bet or wager made exclusively within the Indian lands of a single Indian tribe or between the Indian lands of two or more Indian tribes as authorized by federal law, if the bet or wager and the method by which the bet or wager is made is expressly authorized by and complies with applicable Tribal ordinance or resolution (and Tribal-State Compact, if applicable) and includes certain safeguards regarding such transaction, and if the bet or wager does not violate applicable federal gaming statutes).
- Interstate horseracing transactions (any activity that is allowed under the Interstate Horseracing Act of 1978, 15 U.S.C. § 3001 *et seq.*). This last category of exempt transactions is particularly interesting because while this population of transactions is excluded under the Act, even an agency within the federal government takes issue with this exclusion. The U.S. Department of Justice has consistently taken the position that the interstate transmission of bets and wagers, including bets and wagers on horse races,

[18] For example, we process between 12 million 14 million checks per business day.
[19] 72 Fed.Reg. at 56681.

violates federal law and that the Interstate Horseracing Act did not alter or amend the federal criminal statutes prohibiting such transmission of bets and wagers. Not surprisingly, the horse racing industry disagrees with this position. Apparently mindful of this disagreement, Congress failed to take an unequivocal position on this issue under the Act, leaving this question to be addressed separately through the exemption granted thereunder.

Given the scope and nature of the three exemptions granted expressly under the Act and given the uncertainty associated with the definition of "unlawful Internet gambling," a financial institution endeavoring in good faith to identify restricted activities under the Act faces insurmountable administrative, operational, and systemic challenges, particularly in an ACH transaction. When an ODFI originates numerous ACH debit entries daily, identifying and blocking restricted transactions and identifying exempt transactions can become virtually impossible, especially in the current absence of merchant or business coded identifiers by class. As a practical matter, how can an ODFI in an ACH debit transaction, for example, differentiate between an exempt intrastate bet or wager and an unlawful interstate bet or wager (assuming that the ODFI can even identify an unlawful, restricted bet or wager)? An RDFI in an ACH credit transaction confronts similar challenges in determining the nature of the business activities of the recipient of the proceeds of the ACH transaction, particularly by automated means, given the volume of ACH transactions generally. This identification challenge is further compounded when even Congress fails to provide clear guidance on the subject of bets and wagers on horse races, electing to categorically exempt those falling within the Interstate Horseracing Act of 1978. The compliance undertakings are undermined by the difficulty in identifying these restricted transactions, particularly identification by automated means.

Secondly, as to wire transfer transactions, we confront a unique challenge in applying the proposed regulations: the Agencies provide an exemption from the proposed regulation's requirements for the originator's bank (i.e., the depositary bank sending the wire transfer on behalf of the gambler) and intermediary banks (other than the bank that sends the transfers to a foreign respondent bank). In this connection, the appropriate classification of drawdown requests comes into play. In a drawdown request, we may send to another bank to debit an

account at that bank and wire transfer to us a sum certain.[20] In that case, are we the originator's bank for purposes of the proposed regulation, or is the bank sending the wire transfer in response to our drawdown request the originator's bank? By virtue of the receipt of the proceeds of the wire transfer, do we become the beneficiary's bank?

Conversely, if we receive a drawdown request from another bank to debit a customer's account and wire transfer a sum certain to the requesting bank, are we the originator's bank, or is the bank requesting the wire transfer the originator's bank? Again, by virtue of the receipt of the proceeds of the wire transfer, does the bank originating the drawdown request become the beneficiary's bank? We would appreciate a clarification on this point.

Thirdly, as a matter of process, in the event the Agencies do not comply with our request by reducing the number of payment systems and, indeed, elect to add new payment systems, we strongly recommend the following. If the Agencies entertain adding additional designated payment systems under the final regulations subsequent to their publication, the Agencies ought to provide notice and afford an opportunity to the public to comment thereon similarly to the manner in which the final regulations hereunder will be issued. This process will afford those possibly impacted by the addition of a new designated payment system to voice views on the proposal prior to the adoption of final regulations.

D. Exemptions. The Agencies request comment on all aspects of the exemptions, but in particular whether the exemptions for certain participants in the ACH systems, check collection systems, and wire transfer systems discussed in detail in the Proposal are appropriate.[21]

Let us explore check collection systems. If a U.S. domestic bank receives a check for collection directly from a foreign bank, that U.S. domestic bank is deemed a depositary bank for purposes of the proposed regulations.[22] As noted above, participants will encounter significant difficulty in identifying restricted transactions.[23] We strongly suspect that foreign banks will similarly encounter such difficulty, if not more so. This difficulty will be further compounded by the observation that some forms of gambling are lawful and permissible in certain foreign nations. Wells Fargo has a correspondent relationship with a significant number of foreign

[20] Fedwire type 1031 and SWIFT MT 101.
[21] 72 Fed.Reg. at 56686.
[22] 72 Fed.Reg. at 56699.
[23] The Agencies acknowledge such difficulty. 72 Fed.Reg. at 56690.

banks. The Agencies can appreciate the complex challenges those foreign banks may face in endeavoring to come to terms with the requirements under the Proposal at our behest. Each and every such bank must inventory the gambling laws within its jurisdiction and render a determination on the lawfulness and unlawfulness of its customer's behavior (presumably under advice of counsel) in light of such laws. (Presumably, in this regard, the jurisdiction where the transaction originates, if that jurisdiction is outside the jurisdiction of the domicile of the foreign bank, may also have an impact on that analysis, as it does herein.) Merely providing a term in the agreement between a U.S. domestic bank and a foreign correspondent bank requiring the foreign bank to have reasonably designed policies and procedures in place to ensure that the correspondent relationship will not be used to process restricted transactions is plainly insufficient, especially if Wells Fargo must explain this new requirement to long standing foreign correspondent relationships. Accordingly, we suggest that check collection transactions on behalf of foreign banks be excluded from the final regulations, if the Agencies elect not to exclude the check collection system categorically.

E. ODFI in an ACH credit transaction. The Agencies specifically request comment on whether it is reasonably practical to implement policies and procedures (including, but not limited to, those discussed in the Proposal) for an ODFI in an ACH credit transaction, whether such policies and procedures would likely be effective in identifying and blocking restricted transactions, and whether the burden imposed by such policies and procedures on an originator and an ODFI would outweigh any value provided in preventing restricted transactions and a description of such burdens and benefits.[24]

We have addressed this inquiry previously above. Again, we encourage the Agencies to entertain excluding all ACH transactions from coverage under the Proposal (in addition to the check collection system and the wire transfer system).

We additionally point out that the Agencies appear to be using two standards when a financial institution is alerted to a restricted transaction. Under proposed § __.6(b)(1)(ii), a financial institution is required to have procedures to be followed with respect to a customer if as an ODFI or a third party sender it "becomes aware" that a customer has originated a restricted

[24] 72 Fed.Reg. at 56686.

transaction as ACH debit transactions or if as a RDFI it "becomes aware" that the customer has received restricted transactions as ACH credit transactions.

In contrast to this "becomes aware" standard, the Proposal in that same section uses the "is found to have received" standard with regard to a foreign bank receiving a restricted transaction from the originating gateway operator. While we address the use of multiple standards in the wire transfer context below, suffice it say that the use of a these two standards is highly ambiguous. We encourage the fostering of uniform, unambiguous standards.

F. Wire transfers. The Agencies specifically request comment on whether it is reasonably practical for an originator's bank and an intermediary bank in a wire transfer system to implement policies and procedures (including, but not limited to, those discussed above) that would likely be effective in identifying and blocking, or otherwise preventing or prohibiting, restricted transactions; whether the burden imposed by such policies and procedures on an intermediary bank, an originator, and an originator's bank would outweigh any value provided in preventing restricted transactions and a description of such burdens and benefits; and whether any policies and procedures could reasonably be limited only to consumer-initiated wire transfers, and if so, a description of any costs or benefits of so limiting the requirement. If a commenter believes that the originator's bank or an intermediary bank should not be exempted, the Agencies request that the commenter provide examples of policies and procedures reasonably designed for institutions serving in those functions to identify and block, or otherwise prevent or prohibit, restricted transactions in a wire transfer system.

Let us respond to this solicitation for comments in the order set forth above.

1. Originator's bank and intermediary bank's policies and procedures. Absent an open admission by an originator, an originator's bank may be unable as a practical matter to identify restricted transactions under any policy or procedure given the volume of wire transactions originated by such bank, particularly if that bank is a substantial regional or national enterprise. (A similar observation may be advanced with regard to an intermediary bank.) While an originator's bank may in some wire transfer transactions seek information regarding the purpose of the transfer from the originator, as a practical matter given the manner in which wire transfers may be originated and formatted remotely, this option is not available in many (if not most) instances to the originator's bank. Wire transfers may be regularly initiated by a customer by

automated means through the use of a personal computer unaided by the direct, material intervention of a financial institution.

Even if an originator's bank could secure information regarding the purpose of a wire transfer from its originator, it is not possible presently to pass on this information to an intermediary bank, given the limited number of available fields in a wire transfer information captured from the payment order by the originator's bank for forwarding to the intermediary bank. Further, even if an originator's bank had available optional fields to provide information regarding the purpose of the wire transfer to an intermediary bank, the originator's bank would need to develop a process to identify and capture such additional information in the payment order and transfer that information to the optional field in the wire transfer. This process would involve additional training and expense.

2. Burdens of policies and procedures. The burden involved in developing and implementing such policies and procedures in identifying and blocking, or otherwise preventing or prohibiting, restricted transactions appears to outweigh materially any value provided in preventing restricted transactions. The burdens set forth above include:

- The identification of restricted transactions. This identification presently cannot be performed by automated means.
- The absence of optional fields in the wire transfer available to an originator's bank to pass this identification information to an intermediary bank.
- Even if optional fields were available, the difficulty in capturing the information in the payment order and transferring this information to the wire transfer itself.

3. Limiting the policies and procedures to consumer-initiated wire transfers. We currently do not draw a distinction between wire transfers originated by consumers and wire transfers originated by businesses. This differentiation would involve a significant modification to our wire transfer system, administratively, operationally, and systemically.

G. Overblocking provisions. The Agencies request comment on the proposed approach to implementing the Act's overblocking provisions.[25] Under proposed § __.5(d), the Agencies provide:

[25] 72 Fed.Reg. at 56688.

(d) Nothing in this regulation requires or is intended to suggest that designated payment systems or participants therein must or should block or otherwise prevent or prohibit any transaction in connection with any activity that is excluded from the definition of "unlawful Internet gambling" in the Act as an intrastate transaction, an intratribal transaction, or a transaction in connection with any activity that is allowed under the Interstate Horseracing Act of 1978 (15 U.S.C. 3001 et seq.).

The language in this proposed subsection is unclear. As we read this subsection, it arguably suggests that only a qualifying intrastate or intratribal transaction or a transaction in connection with any activity permissible under the Interstate Horseracing Act of 1978 fall outside the definition of "unlawful Internet gambling." However, in reviewing the proposed definition of "unlawful Internet gambling,"[26] such unlawful gambling also includes all betting and wagering that is unlawful under any applicable federal or state law. Indeed, in the commentary to the proposed definition, qualifying intrastate and intratribal transactions or a transaction in connection with any activity permissible under the Interstate Horseracing Act of 1978 are referenced as examples of transactions falling outside of "unlawful Internet gambling."[27] At the very least, we urge the Agencies to conform § __.5(d) to the definition of "unlawful Internet gambling" so that qualifying intrastate and intratribal transactions and a transaction in connection with any activity permissible under the Interstate Horseracing Act of 1978 are not the exclusive, complete population of transactions falling outside of "unlawful Internet gambling."

We redraw this subsection as follows, as a suggestion in light of the foregoing:

(d) Nothing in this regulation requires or is intended to suggest that designated payment systems or participants therein must or should block or otherwise prevent or prohibit any transaction in connection with any activity that is excluded from the definition of "unlawful Internet gambling" in the Act, including, but not limited to, an intrastate transaction, an intratribal transaction, or a transaction in connection with any activity that is allowed under the Interstate Horseracing Act of 1978 (15 U.S.C. 3001 et seq.).

H. Reasonably designed policies and procedures. While the Agencies did not seek comment directly on the reasonably designed policies and procedures, we offer this observation.

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[26] § __2(t).
[27] 72 Fed.Reg. at 56688.

Under reasonably designed policies and procedures, the Proposal requires a participant's policies and procedures to indicate what it will do if it "becomes aware" that a customer has conducted a restricted transaction through the participant.[28] But the Proposal is unclear at exactly what point a participant will be deemed to "become aware" of such activity. This phrase is particularly confusing in light of the ambiguity surrounding what will constitute a restricted transaction. As the Agencies have noted in the Proposal, the legal analysis for this determination entails interpreting various federal and state gambling laws, which could be further complicated by the fact that whether a transaction is legal or illegal may turn, in part, upon the location of the gambler at the time of the transaction and the location where the bet or wager was made or received.[29] The Proposal also makes note of the disagreement between the U.S. Department of Justice and the horse racing industry as to what constitutes illegal gambling under the Interstate Horseracing Act of 1978. In light of all of this uncertainty, is a mere suspicion of a restricted transaction sufficient to trigger the requisite awareness and, if so, is the expectation that a participant will take certain actions on the basis of a mere suspicion consistent with the Congressional mandate that the agencies ensure that transactions associated with any activity excluded from the Act's definition of "unlawful Internet gambling" are not blocked or otherwise prevented or prohibited by the prescribed final regulations? It is important that the standard be clearly established so that financial institutions and their examiners have a consistent understanding of the standard.

Further to the "becomes aware" standard discussed herein, we also observe that in the ACH,[30] check collection,[31] and wire transfer context [32] (as noted in this letter above and below in other sections of this comment letter) this standard is used along with a "is found to have received" or "is found to have sent (as to checks)" standard. Needless to say, the employment of these multiple standards is highly ambiguous to financial institutions.

I. Due diligence. The Agencies request comment as to the appropriateness of participants incorporating into their existing account-opening procedures the due diligence provisions of the

[28] 72 Fed.Reg. at 56698.
[29] 72 Fed.Reg. at 56681-56682.
[30] Compare § __.6(b)(1)(ii) with § __.6(b)(3).
[31] Compare § __.6(d)(1)(ii) with § __.6(d)(2)(ii).
[32] Compare § __.6(f)(1)(ii) with § __.6(f)(2).

Proposal. The Agencies also request comment on whether, and to what extent, the Proposal's examples of due diligence methods should explicitly include periodic confirmation by the participants of the nature of their customer's business.[33]

In the proposed regulations, as examples of policies and procedures in compliance with the requirements of the Act, such policies and procedures appear to apply a special emphasis on conducting due diligence to ensure that a customer will not conduct restricted transactions.[34] This mandated due diligence is to include screening potential customers to ascertain the nature and scope of their business, but the proposed regulations are unclear as to what a participant is to do with the information it obtains about a customer's business. Since not all gaming involves illegal gambling and since uncertainty surrounds what may or may not be a restricted transaction, it is not at all clear what a participant is expected to do with the due diligence information it collects. Is there some point at which there is an expectation that due diligence will be required to be increased to some form of enhanced due diligence subsequent to the gathering of initial information of a customer's business activities by a participant? Is there some information that will result in an expectation that a participant will be required to do some level of monitoring notwithstanding the fact that the commentary seems to indicate that monitoring does not apply to a number of designated payment systems? It is important that the standard be clearly established so that financial institutions and their examiners have a consistent understanding of the standard.

J. Remedial action. The Agencies request comment on the appropriateness of the Proposal's examples of participant's procedures upon determining that a customer is engaging in restricted transactions through the customer relationship, and whether any additional such procedures should be included as examples.[35]

We are troubled by the assessment of fines as remedies under policies and procedures that are deemed to be reasonably designed to prevent or prohibit restricted transactions.[36] Indeed, we are not aware of any other federal regulation where we undertake to assess fines in light of a customer engaging in apparent restricted transactions. Even if we provide that such fines may be assessed under terms in account agreements, generally, as a matter of contract law, parties are

[33] 72 Fed.Reg. at 56688.
[34] 72 Fed.Reg. at 56698-56699.
[35] 72 Fed.Reg. at 56689.
[36] See §§ __.6(b)(1)(ii)(A) [ACH system examples] and __.6(c)(3)(i) [card system examples].

unable to agree to the assessments of fines and penalties, unless it is impractical or extremely difficult to fix the actual damages.[37] Indeed, the Act itself does not expressly require the assessment of fines by participants as a remedy.

An additional question not squarely addressed in the Proposal is the disposition of such fines, upon assessment by the financial institution. May the financial institution assessing such fines treat such fines as miscellaneous income? If a financial institution were to treat such fines as income, a conflict of interest may arise if that institution views the fines as a revenue source. Does the financial institution have an obligation to treat such fines in some other manner, as dictated by accounting rules? We strongly oppose our having by regulation to assume a virtually quasi-governmental role.

K. Monitoring. The Agencies request comment on whether ongoing monitoring and testing should be included within the examples for ACH, check collection, and wire transfer systems, and, if so, how such functionality could reasonably be incorporated into those systems.[38]

Firstly, as to card systems, Wells Fargo objects to the obligation to monitor transactions as to card systems when this obligation is invoked as to existing customers.[39] This obligation should only apply as to new customers subsequent to the effective date of the final regulations. We ought also not to have any such obligation as to previously posted transaction prior to the effective date of the final regulations. The review of previously posted transactions would be unduly burdensome, especially if such review involves a significant retrospective period.

We object to any monitoring obligation as to ACH systems, check collection systems, and wire transfer systems. The significant number of these transactions occurring on a daily basis would make this undertaking significantly difficult. Further, these transactions are difficult to differentiate and identify by automated means, at least in the present state of the art. We have no available merchant or transaction codes to assist in the identification of transactions by automated means.

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[37] *United Savings & Loan Assn. of California v. Reeder Develop. Corp.* (1976) 57 C.A.3d 282; *City of Vernon v. Southern California Edison Company* (1961) 191 C.A.2d 378.
[38] 72 Fed.Reg. at 56689.
[39] § __.6(c)(2)(ii).

By way of amplification, let us take the case of monitoring wire transfer transactions. Monitoring and testing wire transfers are not currently included in the wire transfer system. We do not have currently a system to analyze patterns of payments. Because Fedwire, SWIFT, and CHIPS's wire transfer formats do not have available fields to designate transaction or merchant codes, ongoing monitoring or testing by automated means is not feasible. Even if such formats could be modified, our experience is that changes to the Fedwire and SWIFT format can take a considerable amount of time; in the case of SWIFT, the change to a format can take as long as two years. Further, once a change to a format is adopted, third party wire transfer application vendors must adopt these changes. Originator's banks and intermediary banks must then follow with appropriate changes to their wire transfer systems.

L. Merchant/business category codes and transaction codes. The Agencies suggest that in some cases it may be reasonably practical for card systems to develop merchant category codes ("MCC") for particular types of lawful Internet gambling transactions. The Agencies specifically seek comment on the practicality, effectiveness, and cost of developing such additional merchant codes.[40]

While merchant acquirers currently may employ MCCs, e.g., "gambling," and electronic commerce indicators, e.g., "Internet," to block by automated means Internet gambling transactions, such MCC identifiers are as to gambling operators generally, not as to those operating unlawful Internet gambling operations, as opposed to lawful Internet gambling operations. For example, as a matter of business decision, we currently do not establish a merchant relationship as a merchant acquirer where the MCC would be "gambling." Even if we were to establish such a relationship, as a practical matter, our blocking system would be unable to identify and differentiate unlawful gambling transactions, as opposed to lawful gambling transactions. Further, as discussed above, even if we could employ automation to differentiate between lawful and unlawful Internet gambling transactions, we would confront great difficulty in differentiating between lawful and unlawful gambling transactions and merchants engaged in such transactions (as discussed above).

Further, even if we could identify those card merchants engaged in unlawful Internet gambling operations and we could block restricted transactions by automated means, they could

contrive methods to secure payment outside of our coverage. For example, a merchant could at its Website provide links to other gateways to secure payment outside of its principal Website. In addition, if a retail merchant were to submit Internet gambling transactions through its physical payment terminal as a non-face-to-face payment transaction, we could not identify that transaction as an online gambling transaction. These activities by merchants outside of our regular, anticipated payment portals would be virtually impossible to detect.

M. Blocking within other payment systems. The Proposal does not include specific methods for identifying and blocking restricted transactions as they are under processing within the examples of procedures for any designated payment systems other than card systems because the Agencies believe that only the card systems have the necessary capabilities and process in place. The Agencies request comment on whether the procedural examples for other designated payment systems should encompass identifying and blocking restricted transactions as they are under processing, and, if so, how such functionality could reasonably be incorporated into the systems.[41]

This inquiry has been addressed through responses in other sections of this letter. However, needless to say, we observe that other than perhaps the card systems no other payment systems have the present capacity systemically to identify and block restricted transactions. Further, we are not sanguine about the development of such functionality within such payment systems, particularly when the identification of restricted transactions, even through operator intervention, is extremely challenging.

N. Cross border arrangements. The Agencies recognize that the issue of the extent of a bank's responsibility to have knowledge of its respondent banks' customers is a difficult one, which also arises in the context of managing money laundering and other risks that may be associated with correspondent banking operations. The Agencies specifically request comment on the likely effectiveness and burden on the Proposal's due diligence and remedial action provisions for cross-border arrangements, and whether alternative approaches would increase effectiveness with the same or less burden.[42]

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[40] 72 Fed.Reg. at 56689.
[41] 72 Fed.Reg. at 56689.
[42] 72 Fed.Reg. at 56690.

Specifically with regard to cross border wire transfers, we have the following question with regard to proposed § __.6(f)(2) providing:

(2) An originator's bank or intermediary bank that sends or credits[43] a wire transfer transaction directly to a foreign bank is deemed to have policies and procedures reasonably designed to identify and block, or otherwise prevent or prohibit restricted transactions, if the policies and procedures include procedures to be followed with respect to a foreign bank that is found to have received from the originator's bank or intermediary bank wire transfer that are restricted transactions, which may address—

(i) When wire transfer services for the foreign bank should be denied; and

(ii) The circumstances under which the correspondent account should be closed.[44]

This proposed subsection appears merely to require an originator's bank or intermediary bank sending a wire transfer directly to a foreign bank to have policies and procedures to address instances when a foreign bank actually receives from the originator's bank or intermediary bank a wire transfer that are restricted transactions. The sanction effect of that discovery could involve a denial of future wire transfer services or, in more severe cases, a closure of the correspondent account of that foreign bank. Please confirm our reading of this subsection.

Additionally, we are unclear by the use of the phrase "is found to have received" as a standard in the subsection set forth above. Is the "is found to have received" standard of identification of restricted transactions different from the "becomes aware of" standard applicable to a beneficiary's bank?[45] If these standards are virtually synonymous, why did the Agencies elect to have these apparently differing standards?

We recommend that the Agencies endeavor to achieve the following through the final regulations:

- The same standard ought to apply to beneficiary's bank, originator's bank, and intermediary banks.
- The standard ought to be "actual knowledge."

[43] We are unclear by the use of this term "credits." Does this term differ from the term "sends?" If both "sends" and "credits" are synonymous, what is the reason for the use of two terms? If the terms are synonymous, we suggest striking "credits."
[44] 72 Fed.Reg. 56699.
[45] See proposed § __.6(f)(ii), 72 Fed.Reg. 56699.

- A financial institution only has actual knowledge of a fact regarding a restricted transaction when that fact is brought to the attention of an officer in that institution who is responsible for that transaction, including the institution's specific compliance obligation with respect thereto.

O. List of unlawful Internet businesses. The Agencies request comment on whether establishment and maintenance of a prohibited list by the Agencies are appropriate, and whether examining or accessing such a list should be included in the final regulation's examples of policies and procedures reasonably designed to identify and block, or otherwise prevent or prohibit, restricted transactions. The Agencies also request comment on whether, if it were practical to establish a fairly comprehensive list and a participant routinely checked the list to make sure the indicated payee of each transaction the participant processed on a particular designated payment system is not on the list, the participant should be deemed to have, without taking any other action, policies and procedures reasonably designed to prevent or prohibit restricted transactions with respect to that designated payment system. Similarly, the Agencies also request comment on whether, if such a list were established and a participant routinely checked the list to make sure a prospective commercial customer was not included on the list (as well as periodically screening existing commercial customers), the participant should be deemed to have, without taking any other action, policies and procedures reasonably designed to prevent or prohibit restricted transactions. Finally, assuming such a list were established and became available to all participants in the designated payment systems, the Agencies request comment on the extent to which the exemptions provided in § __.4 of the proposed regulations should be narrowed.

Any commenter believing that such a list should be included in the final regulation's examples of policies and procedures is requested to address the issues discussed above regarding establishing, maintaining, updating, and using such a list. The Agencies also request comment on any other practical or operational aspects of establishing, maintaining, updating, and using such a list. Finally, the Agencies request comment on whether relying on such a list would be an

effective means of carrying out the purposes of the Act, if unlawful Internet gambling businesses can change their corporate names with relative ease.[46]

While we appreciate the value of a prohibited list that the Agencies may establish and maintain, we also understand that this undertaking may be extremely difficult. Consequently, we suggest at least two mitigation matters for the Agencies consideration:

- Define the term "unlawful Internet gambling" with greater precision and clarity so that impacted financial institutions may be able to identify restricted transactions with greater regularity and frequency.
- If such a definition may not be drawn by the Agencies, expand and broaden the exemptions set forth in proposed § __.4 to include all participants in the ACH system, the check collection system, and the wire transfer system.

If the Agencies are unable to provide a clearer definition of the term "unlawful Internet gambling" and if the Agencies have no appetite to exclude the ACH system, the check collection system, and the wire transfer system from coverage under the Proposal, we believe that the Agencies ought to consider issuing a government generated list in some form, even if the list may have limited effect.

In order to compile a list of businesses engaged in unlawful Internet gambling, we are mindful that one of the Agencies or other government body (such as FinCEN) would have to assume the responsibility of interpreting the various federal and state gambling laws in order to determine whether the business activities of each business appearing to conduct some type of gambling-related functions are unlawful under those laws. These interpretations will regularly require updating as the various laws change from time to time.

Further, the Agencies or other government body should grant appropriate and reasonable due process to avoid inflicting undue harm to lawful businesses by incorrectly including them on the list without adequate review. The high standards needed to establish and maintain such a list likely would make compiling such a list time-consuming and perhaps under-inclusive. To the extent that Internet gambling businesses can change the names they use to receive payments with relative ease and speed, such a list may also be outdated quickly. It is understood that although any list created may fail to identify small unlawful Internet gaming Websites, the list may offer a

[46] 72 Fed.Reg. at 56690-56691.

useful method to assist in identifying the major unlawful Internet gambling operations. The creation and maintenance of a list of unlawful Internet gambling businesses would allow financial institutions to achieve the goals of the Act without unduly burdening the financial community.

When a financial institution scrubs the prospective customer against that government list in accordance with its policies and procedures issued under § __.6, that financial institution should be deemed to have policies and procedures reasonably issued to identify and block, or otherwise prevent or prohibit, restricted transactions.

In any event, the Agencies should recognize that no private entity is in any position to compile a list, and they should make it clear in the final regulations or in the accompanying commentary that neither the Act nor the regulations require payment systems or their participants to compile a list of businesses that engage in unlawful Internet gambling, and that no regulatory or law enforcement action will be taken against a payment system or participant of a payment system solely on the basis of its not having or using such a list.

III. Wells Fargo's general comments. Wells Fargo offers the following comments generally to the Proposal.

A. Money transmitting business. With regard to the money transmitting business, we believe that this business raise unique issues under the Proposal, as follows:

- The definition of a "money transmitting business" is set forth in 31 U.S.C. § 5330(d), without reference to any regulations prescribed by the Secretary of the Treasury. Money transmitting businesses are defined to include persons who cash checks.[47] The U.S. Treasury regulations issued under the Bank Secrecy Act (the "BSA") limit the definition of check cashers by excluding from the definition persons who do not cash checks in amounts greater than $1,000.00.[48] By failing unfortunately to include any reference to the regulations issued under the BSA, under the Proposal as a possible unintended consequence any retail business that cashes any check for a customer for any amount becomes a money transmitting business. Since "restricted transactions" include funds transmitted through a money services business and, since the policies and

[47] 31 U.S.C. § 5330(d)(1)(A).
[48] 31 C.F.R. § 103.11(uu)(2).

procedures that need to be developed are required to identify and block, or otherwise prevent or prohibit, restricted transactions, it is unclear whether the policies and procedures mandated under the proposed regulations would be required to consider all businesses that fit within the definition of a money transmitting business, including retailers who may cash small-dollar checks from time to time for their customers.

- The discrepancy between the definition of a money transmitting business for purposes of the BSA regulations and the unlawful Internet gambling Proposal is likely to complicate the policies and procedures that financial institutions develop to deal with this class of customers.
- Unlike other designated payment systems, no participant in a money transmitting business is exempt from the Proposal. A money transmitting business will frequently use another designated payment system in the middle of a transaction. For example, Western Union may move funds from one of its facilities to another of its facilities by means of a wire transfer. In such instances, are financial institutions that are intermediaries in a transfer of funds covered by the exemptions applicable to wire transfers or are they considered participants in overriding money transmitting business activity. We suspect that the Agencies intend to exclude the intermediate wire transfer activity from coverage, but this ambiguity should be clarified.

IV. Conclusion. Wells Fargo wishes to express its appreciation for the opportunity to offer its comments to the Proposal. If you have any questions to the foregoing, please do not hesitate to contact us.

Sincerely,

Ted Teruo Kitada
Senior Company Counsel

cc: Linda A. Leo
Craig D. Litsey
Kenneth J. Bonneville, Jr.

STATEMENT OF
HARRIET MAY
PRESIDENT & CEO, GECU OF EL PASO, TX
ON BEHALF OF THE

CREDIT UNION NATIONAL ASSOCIATION (CUNA)

ON THE
UNLAWFUL INTERNET GAMBLING ENFORCEMENT ACT
BEFORE THE
HOUSE SUBCOMMITTEE ON DOMESTIC AND INTERNATIONAL MONETARY POLICY, TRADE, AND TECHNOLOGY

APRIL 2, 2008

Good morning, Chairman Gutierrez, Ranking Member Paul, and members of the Subcommittee.

Thank you for inviting me to testify today on the Unlawful Internet Gambling Enforcement Act of 2006 on behalf of the Credit Union National Association (CUNA).

I am Harriet May, President and CEO of GECU in El Paso, Texas. I am a member of the CUNA Board of Directors and serve on CUNA's Executive Committee as Board Secretary. CUNA is the largest credit union trade association, representing approximately 90 percent of the nation's 8,400 state and federally chartered credit unions which serve approximately 90 million members.

GECU (formerly known as Government Employees Credit Union) has served the families of El Paso (TX) County since 1932, when 11 postal employees pooled $5 each to serve fellow workers. Today, we are the largest locally owned financial institution in the area, with just over $1.4 billion in assets and serving over 277,000 members.

When I received the invitation to appear today, I must say that I relished the opportunity to talk with you about the range of serious and practical concerns that CUNA believes will make compliance under the Act extremely difficult, if not impossible for financial institutions. That is why our comment letter on the proposed rules took the extraordinary step of

urging that a moratorium be imposed on the implementation of the law until a workable regulation could be developed.

I do want to be clear that CUNA supports enforcement of reasonable laws to prohibit unlawful Internet gambling. However, the Act and proposed rules would inflict a set of unreasonable policing requirements which will undoubtedly prove difficult for financial institutions to meet. In addition, Congress' objective to crack down on illegal Internet gambling would not be furthered under these strictures. A set of unclear and multi-faceted new requirements such as what is proposed, would without question divert credit unions from their intended purpose of providing financial services to their members.

Given the time constraints of the hearing today I would like to focus on major concerns that have left us quite frankly frustrated with the law and proposed regulations.

One of our most fundamental concerns with implementing this law is that credit unions and other financial institutions are in business to provide financial services to their communities. With the current mortgage crisis and other economic pressures, we hope that Congress will reconsider whether this is an appropriate time to ask us to dedicate resources to try to comply with what we view as an unworkable law. I want to emphasize that GECU and other credit unions have never made predatory subprime mortgage loans – those types of loans would be totally contrary to the philosophy and operations of member-owned credit unions. But all of us are facing the fallout of those loans.

Credit unions and other financial institutions are already burdened with heavy policing responsibilities. Our compliance responsibilities under the Bank Secrecy Act and Office of Foreign Assets Control (OFAC) rules are extraordinary. We do not think that the Internet Gambling law could be implemented without creating a list similar to what OFAC publishes to tell financial institutions who are the "bad guys."

We are equally concerned that while institutions would be required to identify and block transactions that fund illegal gambling activities, the proposed rules provide no mechanism to verify when a payment transaction is intended for "illegal Internet gambling." The explanatory information

accompanying the proposed regulation says that it would basically be impossible for the federal government to develop and maintain such a list.

We feel that while it will be difficult for the federal government to figure out whose transactions are to be blocked, it will be that much harder for individual financial institutions that handle checks, wire transfers, and credit cards to do so.

HR 2046, the Internet Gambling Regulation and Enforcement Act, introduced by House Financial Services Committee Chairman Barney Frank would require Internet gaming businesses to be licensed and pay user fees to the Financial Crimes Enforcement Network (FinCEN). The bill could be the vehicle for the Department of Justice to take the lead in not only monitoring the entities that are complying with registration, but also developing a list of those businesses or individuals involved in illegal Internet gambling activities. Such an approach would promote compliance for institutions by providing them a much greater level of certainty as to whether a transaction for a particular entity should be prevented. Exemptions and safe harbor provisions would help provide a regulatory framework that might actually be able to work.

Even if a list is developed, the current Internet Gambling law contains a basic flaw that also exists with complying with OFAC requirements, and that is the inclusion of checks under the law. The law says that checks cannot be written to pay illegal Internet gambling debts. But the check-processing systems would come to a stand-still if financial institutions would have to review each check to determine if the payment was made to fund illegal gambling activities. Software packages have been developed to assist in the compliance with OFAC requirements for monitoring new accounts, wire transfers and other activities, but never can be used for matching names on a check's payable to line. Similar software could be developed to check names on a government list for illegal Internet gambling activities, but would have the same limitations.

Under the Act, institutions must establish and implement policies and procedures to identify and block restricted transactions or rely on policies and procedures established by the payments system, as provided under the proposal. We are concerned that the scope of these requirements is not realistic. To illustrate, the proposal calls for participants including card issuers to monitor certain websites to detect unauthorized use of a covered

card system, including monitoring and analyzing payment patterns. Such activities would be time consuming and would detract from the institution's own businesses purposes.

The examples also direct covered entities to address "due diligence" without defining or explaining what is meant by that term. Regulators intend that due diligence apply when establishing or maintaining a customer relationship and that a flexible risk based approach be used, based on the level of risk a customer poses. This vague guidance makes it difficult for financial institutions to adequately comply.

The Act also states that institutions that "reasonably believe" a transaction is restricted will not incur liability for incorrectly blocking the transaction. We appreciate the safe harbor but need clear guidance on what is necessary for institutions to show that their belief was "reasonable." There should also be a safe harbor when institutions with good faith policies and procedures inadvertently misidentify and thus fail to block a restricted transaction.

Further, the regulators contemplate that when restricted transactions are involved, an account could be closed under an institution's compliance procedures. The safe harbor should cover situations in which an account is closed based, in good faith, on an erroneous analysis or treatment of a transaction that the institution reasonably believed was restricted. Situations involving a decision to decline to open an account should also be covered by the safe harbor.

The federal financial regulators will be responsible for enforcing the rule. However, it is not clear how this enforcement would occur.

Lastly, the Act does not include an effective date. However, while we do not believe this proposed regulation should be promulgated, if the agencies are required to proceed, institutions should have at least 18 months if not longer to try to figure out what to do and conform to the new requirements.

In summary, Mr. Chairman, CUNA certainly appreciates your leadership in reviewing this matter. We do not condone illegal Internet gambling or want to see it continue or grow. However, the current statute and implementing proposal contain several components of great concern, and we urge Congress to take action to address the hardships that will otherwise arise.

For release on delivery
10:00 a.m. EDT
April 2, 2008

Statement of

Louise L. Roseman

Director, Division of Reserve Bank Operations and Payment Systems

Board of Governors of the Federal Reserve System

before the

Subcommittee on Domestic and International Monetary Policy, Trade, and Technology

of the

Committee on Financial Services

U.S. House of Representatives

April 2, 2008

Chairman Gutierrez, Ranking Member Paul, and members of the Subcommittee, I am pleased to appear before you to discuss the implementation of the Unlawful Internet Gambling Enforcement Act of 2006. I will provide an overview of the Act and of the proposed rule to implement the Act that the Federal Reserve Board and the Secretary of the Treasury (the Agencies) published for comment. I will also highlight the major issues raised in the comments we received.

Unlawful Internet Gambling Enforcement Act of 2006

The Act prohibits gambling businesses from accepting payments in connection with unlawful Internet gambling. Such payments are termed "restricted transactions." The Act also requires the Board and the Secretary of Treasury, in consultation with the Attorney General, to prescribe regulations requiring designated payment systems and their participants to establish policies and procedures reasonably designed to identify and block or otherwise prevent or prohibit the acceptance of restricted transactions.

The Act does not spell out which gambling activities are lawful and which are unlawful, but rather relies on the underlying substantive Federal and State laws. The Act does, however, exclude certain intrastate and intratribal wagers from the definition of "unlawful Internet gambling," and also excludes any activity that is allowed under the Interstate Horseracing Act of 1978. The activities that are permissible under the various Federal and State gambling laws are not well-settled and can be subject to varying interpretations. Congress recognized this fact when it included in the Act a "sense of Congress" provision that states that the Interstate Horseracing Act exclusion "is not intended to resolve any existing disagreements over how to interpret the relationship between the Interstate Horseracing Act and other Federal statutes."

The Act directs the Agencies to designate payment systems that could be used to facilitate restricted transactions. A designated payment system and its participants must comply with the rule. Congress recognized, however, that it may be difficult to block restricted transactions made in certain payment systems, and directed the Agencies to exempt transactions or designated payment systems from the rule's requirements in those cases where it is not reasonably practical to block restricted transactions. By including this requirement, Congress recognized the importance of an efficient payment system to a well-functioning economy and of ensuring that the Agencies' rule does not have a material adverse effect on payment system efficiency. In addition, the Act requires that the regulations identify the types of policies and procedures, including non-exclusive examples, that the Agencies would deem reasonably designed to prevent or prohibit restricted transactions. The Act also requires the Agencies to ensure that their regulations do not block or otherwise prevent or prohibit transactions related to activity that is explicitly excluded from the definition of unlawful Internet gambling.

The Proposed Rule and Comments Received

Overview of the proposed rule. Over the course of this rulemaking, the Agencies have done a considerable amount of outreach to payment system representatives, gaming interests, Federal and State regulators, and others. These consultations enabled the Agencies to gain a better understanding of gaming and its regulatory structure, and the role the various payment systems play in facilitating gaming. Although Board staff is quite familiar with the operations of many types of payment systems, this consultation provided a deeper understanding of certain payment systems, such as money transmitting businesses (for example, Western Union, MoneyGram, and PayPal), and allowed the Agencies to better focus on formulating options for policies and procedures that would be practical for those systems to comply with the Act.

In October 2007, the Agencies published for comment a proposed rule to implement the Act. The proposed rule (1) designates payment systems that could be used by participants in connection with a restricted transaction, (2) exempts certain participants in certain designated payment systems from the requirements of the regulation, and (3) requires non-exempt participants to establish and implement policies and procedures reasonably designed to prevent or prohibit restricted transactions.

For each designated payment system, the proposed rule sets out non-exclusive examples of policies and procedures for non-exempt participants in the system that the Agencies believe are reasonably designed to prevent or prohibit restricted transactions. These examples are tailored to the particular roles participants play in each payment system. The examples include policies and procedures that address methods for conducting due diligence in establishing and maintaining a customer relationship designed to ensure that the customer does not originate or receive restricted transactions through the customer relationship. The examples also include policies and procedures that address remedial actions with respect to a customer if the participant becomes aware that the customer has originated or received restricted transactions through the customer relationship. Examples applicable to card systems and money transmitting businesses include procedures to address ongoing monitoring or testing to detect possible restricted transactions and, in the case of card systems, establishing transaction codes and merchant category codes that enable the card system or card issuer to identify and deny authorization for a restricted transaction.

More than 200 organizations and consumers submitted comments on the proposal. Many of the comments were directed toward the Act itself. Most consumers who commented indicated that the Act represents an inappropriate governmental intrusion into citizens' private affairs.

Other commenters expressed concern that the Act will exacerbate the U.S.'s difficulties with the World Trade Organization related to Internet gambling. Some banks warned that the cumulative effect of the increased compliance burden of this and other laws will adversely affect the competitiveness of the U.S. payment system. In contrast, some commenters supported the Act's goals, noting the problems that Internet gambling causes for individuals who gamble beyond their means.

I will now highlight certain aspects of the proposed rule and the associated comments that the Agencies received.

Determination of what constitutes unlawful Internet gambling. Like the Act, the proposed rule did not specify what constitutes unlawful Internet gambling. Lack of clarity on this topic in both the Act and the proposed regulation was the most prominent concern raised by the commenters. Commenters that represent payment systems and their participants stressed that uncertainty about what constitutes unlawful Internet gambling would make compliance with the rule very difficult and burdensome. Commenters generally supported bright-line mechanisms for determining which transactions they should block. Clarity on this point would permit them to design policies and procedures that they could be assured would meet the rule's requirements. A number of commenters recommended that the Agencies develop a list of gambling businesses whose transactions should be blocked. While some of these commenters acknowledged the limited effectiveness of such a list, they desired the certainty and efficiency that it would provide. Other commenters suggested that the rule should place the onus on the Internet gambling business to demonstrate to its bank the legality of its transactions. Still others, including some gambling businesses and many consumers, asked that the rule clarify that certain types of gambling, such as pari-mutuel betting or poker, are lawful.

Designated payment systems. The Agencies proposed designating a broad range of payment systems that could be used in connection with Internet gambling. Designated payment systems include automated clearinghouse (ACH) systems, card systems (including credit card, debit card, and prepaid or stored-value systems), check collection systems, money transmitting businesses, and wire transfer systems (such as Fedwire and CHIPS). Commenters generally concurred with the scope of the payment system designations.

Exemptions. The Agencies considered instances when it would not be reasonably practical to identify and block, or otherwise prevent or prohibit, restricted transactions. The proposed rule did not exempt from compliance any designated payment system in its entirety, but rather exempted certain participants in the ACH, check collection, and wire transfer systems. With respect to *domestic* transactions, the proposed rule exempts all participants in these systems except for a participant that would have a customer relationship with an Internet gambling business. The institution that has the customer relationship with that business is in the best position to determine the nature of the customer's business and whether the customer is likely to receive restricted transactions for credit to its account. The Agencies believe it is not reasonably practical for other parties to transactions in these systems to identify restricted transactions because these systems do not have the functional capabilities in place for identifying and blocking payments made for specific purposes or initiated in specific ways, such as on the Internet. For that reason, some banks recommended that these systems be exempt from the rule altogether. The proposed rule did not include exemptions for any participant in a card system or money transmitting business; rather, the Agencies tailored the examples of policies and procedures to the functional capabilities of those systems and their participants.

Due diligence. As I noted earlier, the proposed rule contained examples of policies and procedures that would comply with the rule. Those examples included procedures to conduct due diligence in establishing and maintaining commercial customer relationships to ensure that commercial customers do not originate or receive restricted transactions. Bank commenters generally believed that such due diligence could be performed at the time of account opening for accounts established following the effective date of the regulation if they had a mechanism to readily determine which Internet gambling activity was unlawful. They indicated it would be very difficult and burdensome, however, to ascertain which existing business customers conduct Internet gambling activity, because they have not maintained records on their accounts in a manner that would readily permit identification of such accounts. This requirement would be particularly challenging for the largest banks, which have millions of commercial account relationships.

Cross-border transactions. Most unlawful Internet gambling businesses are based outside the United States and therefore do not have account relationships with U.S. financial institutions. Instead, their accounts are held at foreign institutions, and restricted transactions enter the U.S. payment system through cross-border relationships between those foreign institutions and U.S. financial institutions or payment systems. The proposed rule, therefore, places responsibility on U.S. payment system participants that send transactions to, or receive transactions from, foreign institutions to establish policies and procedures reasonably designed to prevent these restricted transactions. For example, a U.S. correspondent bank could require in its account agreement that foreign institutions have policies and procedures in place to avoid sending restricted transactions to the U.S. participant.

Commenters stated that measures to prevent foreign institutions from sending restricted transactions to the United States would likely be unworkable. They believed that most foreign banks would not agree to modify their contracts with U.S. banks, particularly if Internet gambling is legal in a foreign institution's home country. Detecting and preventing cross-border Internet gambling transactions presents challenges that differ from other criminal financial transactions, such as money laundering or terrorist financing. Laws in many other jurisdictions impose compliance obligations upon financial institutions with respect to those types of financial crime; there are, however, few comparable compliance requirements with respect to Internet gambling.

Given that Internet gambling is lawful in many countries where U.S. banks have correspondent relationships, it may be particularly difficult to craft workable procedures to prevent individuals in the United States from making payments to a foreign Internet gambling company's account at a foreign bank. Moreover, commenters noted that, given the complexity of U.S. gambling law, it is unrealistic for foreign institutions to ascertain which forms of Internet gambling are unlawful and therefore should be prevented.

Many of these cross-border correspondent relationships support large volumes of daily payments that are wholly unrelated to gambling. It seems impractical to require U.S. banks to end these relationships because some small percentage of their overall payments may be directed toward unlawful Internet gambling. Therefore, there may be limited options for dealing with the international banking relationships through which most unlawful Internet gambling transactions are processed without causing significant disruption to international payment flows.

Overblocking. The proposed rule implements the Act's overblocking provision by stating that nothing in the regulation is intended to suggest that payment systems or their

participants must or should block transactions explicitly excluded from the definition of unlawful Internet gambling. Banks and other payment system participants supported the proposed rule's implementation of the Act's overblocking provision, stating that the Act does not require that these gambling transactions, or any other transactions, be processed, but, instead, simply requires that the regulation itself not mandate that these gambling transactions be blocked. Some of these commenters indicated that, even before the Act's passage, they had decided to avoid processing any gambling transactions, even if lawful, because these transactions were not sufficiently profitable to warrant the higher risk they posed. In contrast, some organizations representing gaming interests commented that the rule should *require* payment system participants to process transactions excluded from the Act's definition of unlawful Internet gambling. Certain gaming interests recommended that the rule's policies and procedures for card systems at a minimum include the establishment of separate merchant category codes for the types of gambling that are not defined as unlawful under the Act. As noted in the proposal, the Agencies believe that the Act does not provide the Agencies with the authority to require designated payment systems or participants in these systems to process any gambling transactions, including those transactions excluded from the Act's definition of unlawful Internet gambling, if a system or participant decides for business reasons not to process such transactions. Nor do we possess any other authority that would allow us to do so.

Conclusion

In recent years, funding Internet gambling through the U.S. payment system has become more difficult, due in large part to steps card issuers and money transmitting businesses have already taken on their own initiative to prevent these transactions. Board and Treasury staffs are currently focused on developing a final rule that leverages existing practices to prevent unlawful

Internet gambling transactions and provides additional and reasonably practical examples of actions that U.S. payment system participants can take to further impede the flow of restricted transactions through the U.S. payment system. As the comments to the proposed rule make clear, this is a challenging task, and the ability of the final rule to achieve a substantial further reduction in the use of the U.S. payment system for unlawful Internet gambling is uncertain. As part of this effort, we are carefully considering all comments received on the proposed rule and determining what modifications may be appropriate in light of the issues raised by those comments. Our objective is to craft a rule to implement the Act as effectively as possible in a manner that does not have a substantial adverse effect on the efficiency of the nation's payment system.

I would welcome any questions that the Committee members may have.

STATEMENT

OF

LEIGH WILLIAMS

ON BEHALF OF BITS AND THE FINANCIAL SERVICES ROUNDTABLE

BEFORE THE

UNITED STATES CONGRESS
SUBCOMMITTEE ON DOMESTIC AND
INTERNATIONAL AND MONETARY POLICY
COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

HEARING ON
PROPOSED UNLAWFUL INTERNET GAMBLING ENFORCEMENT ACT
REGULATIONS: BURDEN WITHOUT BENEFIT?
APRIL 2, 2007

TESTIMONY OF LEIGH WILLIAMS, BITS PRESIDENT

Thank you Chairman Gutierrez , Ranking Member Paul and members of the Subcommittee for the opportunity to testify on the Unlawful Internet Gambling Enforcement Act (UIGEA). My name is Leigh Williams and I am president of BITS. BITS is the technology division of The Financial Services Roundtable, leveraging intellectual capital to address issues at the intersection of financial services, operations, and technology. Pursuant to your invitation letter, I am pleased to provide testimony on the regulations proposed by the Treasury Department and Federal Reserve Board of Governors on "Prohibition on Funding of Unlawful Internet Gambling".

On December 12, 2007, BITS and Financial Services Roundtable ("the Roundtable") submitted comments to the Treasury Department and the Federal Reserve Board enumerating concerns with the proposed rule. We submitted our comments after extensive discussion among operations experts from our member companies. In summary, the proposed regulation designates certain payment systems that could be used in connection with unlawful Internet gambling transactions restricted by the Act and requires financial institutions to establish policies and procedures to enable compliance. The statute and the proposed rule greatly expand the role of financial institutions to police laws. Attached to my testimony is a copy of our detailed comment letter. I would like to highlight our key concerns.

Overall, we appreciate efforts by the Treasury Department and Federal Reserve Board Agencies to minimize the compliance burden in the proposed rule given the fundamental requirements placed on these agencies by the underlying statute. Our member financial institutions are *very* concerned that even with final adoption of our recommendations, the rule could impose significant compliance burdens on financial institutions by increasing their role in policing illegal activities, determining whether a transaction is illegal, or by imposing ambiguous compliance requirements that could be subject to wide variations in interpretation by regulators and law enforcement agencies. We believe these functions are more appropriate for law enforcement agencies.

Clarify Key Terms and Monitoring Requirements

The Proposed Rule contains several terms and compliance requirements that are too vague and open to interpretation. Unless these terms and requirements are clarified, it will be extremely difficult and costly for financial institutions to comply. This ambiguity could be a significant problem both in how financial institutions interpret the requirements and how financial regulators enforce them.

In particular, we are very concerned that the definition of "unlawful Internet gambling" is so vague that participants in designated payment systems will be unable to determine how to comply with the proposed regulations. Without clarity, this could impose a significant burden on financial institutions to determine what is legal versus illegal.

Overall, the Proposed Rule does not provide adequate detail on the policies and procedures financial institutions must have in place to comply. Financial institutions need to know if a transaction is restricted by knowing many details of the transaction including the location of where the transaction is initiated and legality of the transaction. There are numerous examples of how this could play out given the location of an individual placing a bet, eligibility of the individual making the bet, the location of the entity processing the bet, and the location of the technology that may process the bet.

The result of the definition's lack of specificity is that participants in designated payment systems are left to determine without adequate information whether state or federal anti-gambling laws apply to a particular transaction. However, the formats used by most payment systems do not provide banks with the information such as the location of the person placing a bet that they would need in order to determine whether a transaction is related to "the participation of another person in unlawful Internet gambling."

It is unlikely there will be any unlawful Internet gambling *businesses*, but only unlawful Internet gambling *transactions*. Businesses that engage in unlawful Internet gambling transactions also will likely engage in lawful transactions that are not prohibited by the proposed regulations and for which there is no reliable safe harbor. The Agencies' decision not to fully define unlawful Internet gambling places our members in a very difficult position. They cannot know if a transaction is restricted unless they have in hand specifics of the transaction that in almost all instances they will not have.

We believe the regulation cannot work unless financial institutions and other financial transaction providers are given clear and specific rules. These rules should clarify: 1) the types of transactions that must be identified or blocked so financial institutions can determine on a real-time basis which transactions involve unlawful Internet gambling; <u>and</u> 2) a safe harbor for any transactions for which this determination is not absolutely clear at the time the transaction takes place.

The proposed rule includes other definitions that could create significant confusion and inconsistent compliance standards. For example, the terms "due diligence," "reasonable due diligence," and "becoming aware" (of when customers and merchants are involved in illegal Internet gambling) could be interpreted by regulators in different ways. We *urge* the Agencies to clarify what exactly the standard is when a bank "becomes aware" that a commercial customer has received an unlawful Internet gambling-related transaction. We believe that the appropriate and only reasonable standard is fact-based actual knowledge.

We *recommend* that the Agencies clarify in the final rule that the regulations do not create an additional monitoring requirement for entities that are subject to anti-money laundering monitoring and reporting obligations, and that participants in designated payment systems be deemed to have satisfied their monitoring obligations under the regulations if they comply with their existing policies and procedures with respect to their anti-money laundering, anti-terrorist financing, OFAC-compliance, and suspicious-activity reporting obligations.

Financial institutions cannot do OFAC-type screening unless the government provides an OFAC-style list of names, which the Agencies have made clear they are reluctant to do. Payment systems and financial institutions also are unlikely to compile lists of unlawful Internet gambling businesses for the same reasons that the Agencies have given, together with the added considerations that they do not have the resources that the government has to do the investigations that would be necessary for compiling a list and because of concerns about possible legal liability to any entity that is mistakenly placed on a list.

The proposed rule places the onus on financial institutions to know the purpose and legality of payments. Since gambling laws are geographically based, financial institutions would need to determine where the customer is located when conducting gambling activities and where computers and other equipment to process the transaction are located. For example, the use of the Internet raises challenges in that data is transmitted across state and international lines. Further, payments providers do not have policies and procedures to identify and thus prevent restricted transactions. We believe merchants, not financial institutions, are in a much better position to identify an illegal gambling payment and monitor it.

Strengthen Safe Harbor Provisions

Given the difficulty in defining what is unlawful, any policies and procedures developed by designated payment systems participants could prevent many lawful transactions. Consequently, it is critical that designated payment systems participants be protected against third party actions from legitimate

businesses that are blocked pursuant to the policies and procedures adopted by those participants to meet their obligations under the Act and regulation. Our members *support* the "overblocking" provision in the Proposed Regulation. This would allow designated payment systems participants to develop and implement policies and procedures that are flexible and workable so long as they are "reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions," even if it sometimes results in the prevention of legal transactions.

Clarify "Blocking" to Avoid Confusion with OFAC

The Proposed Regulation uses the term "block" to describe the actions that financial institutions and others must take with respect to restricted transactions. This term is confusing because of the way it is used in the OFAC regulations. When OFAC uses that term it means that a bank that receives a transaction involving a blocked party must not only cease processing the transaction, it must pay the amount of the transaction into a blocked account so the blocked party is denied the use of the funds. We *recommend* that the final regulations contain a definition of "block" that makes it clear that a financial institution blocks a transaction when it rejects the transaction and returns any payment that the financial institution has received in respect to the transaction. The final regulation should clarify that there is no requirement that a financial institution freeze the amount of a prohibited transaction and pay the amount into a frozen account.

Clarify Requirements for Maintaining a List of Illegal Gambling Entities

The Agencies correctly anticipate the costs of maintaining a list of illegal gambling entities, which includes gathering and updating the information, providing a legal analysis, and assuming legal liability. Developing and maintaining such a list would be a significant compliance burden for each institution. We believe the Government is far better suited to maintain such a list since it can serve as the central database for all financial institutions to use. If such a list were maintained, arguably, it should include domestic and offshore entities. Of course, there is precedent in that the Treasury Department currently maintains lists that financial institutions are required to check under OFAC. As a public policy matter, we question whether the cost of maintaining a list is the best or most appropriate use of public or private resources.

Clarify How Regulators Will Enforce the Rule

It is unclear how financial institutions and regulators would enforce the rule given that there are undefined penalties for non-compliance. It is unclear whether fines would be assessed by each of the regulators or by Treasury and whether fines will be administered in case of a breach. As noted above, we *recommend* that the

Agencies emphasize that financial institutions may rely on existing monitoring systems (e.g., Anti-Money Laundering) and not develop new systems. Further, we *urge* the regulators to apply risk-based and consistent procedures across different charter types should the regulators determine that examination procedures are necessary.

In addition, the Proposed Rule raises the specter of financial institutions acting as the judge and jury and thus summarily assessing fines against a customer. We do not believe it is appropriate for the government to require financial institutions to impose fines on customers. We *urge* the Agencies to *clarify expectations* and differentiate requirements, such as the OFAC rules, which require financial institutions to freeze funds and place them in escrow.

Extend the Implementation Deadline

The Proposed Rule states that the "final regulations take effect six months after the joint final rules are published." We believe a six month implementation deadline is unrealistic because of the time it will take financial institutions and the various payment organizations to develop policies and procedures and to modify systems. It takes considerable time for payments organizations to change their policies and procedures once a final rule is in place. Therefore, the Roundtable *recommends* that the Agencies extend the implementation deadline to no less than 24 months after issuance of the final rule or 12 months after the payments associations have completed implementation of its changes in policies and procedures.

Conclusion

In conclusion, the Roundtable appreciates the efforts by the Agencies to minimize the compliance burden given the language in the statute. However, we urge the Agencies to take the following steps to further minimize the compliance burdens on financial institutions:

- Clarify key definitions and clarify monitoring requirements;
- Strengthen Safe Harbor provisions;
- Clarify "blocking" to avoid confusion with OFAC;
- Clarify expectations of financial institutions to maintain a list of illegal gambling entities;
- Clarify how regulators will enforce the rule; and
- Extend the implementation deadline.

We applaud efforts to respond to these concerns by the Agencies and by the Congress.

Thank you for your time. I'm happy to answer any questions you may have.

THE FINANCIAL SERVICES ROUNDTABLE

1001 PENNSYLVANIA AVE., NW
SUITE 500 SOUTH
WASHINGTON, DC 20004
TEL 202-289-4322
FAX 202-628-2507

E-Mail info@fsround.org
www.fsround.org

BITS
FINANCIAL SERVICES
ROUNDTABLE

Via www.regulations.gov

Jennifer J. Johnson
Secretary, Board of Governors
The Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

Department of the Treasury
Office of Critical Infrastructure Protection and
Compliance Policy
Room 1327 of Main Treasury Building
1500 Pennsylvania Avenue, N.W.
Washington DC, 20220

Re: Prohibition on Funding of Unlawful Internet Gambling
Docket Numbers: R-1298/Treas-DO-2007-0015

Dear Sir and Madam:

The Financial Services Roundtable and BITS (hereafter together referred to as "Roundtable") [1] appreciate the opportunity to comment on the Treasury Department's and the Federal Reserve Board's ("Agencies") proposed rule on "Prohibition on Funding of Unlawful Internet Gambling." The proposed rule implements provisions of the Unlawful Internet Gambling Enforcement Act of 2006.

The proposed rule:

- Designates certain payment systems that could be used in connection with unlawful Internet gambling transactions restricted by the Act;
- Requires the establishment of policies and procedures to enable compliance;
- Establishes those exempt from the requirements; and
- Describes the types of policies and procedures that non-exempt participants in designated payment systems can use to ensure compliance, and include non-exclusive examples of such procedures.

The Roundtable appreciates the efforts by the Agencies to minimize the compliance burden improved by the language in the statute. However, our members continue to be *very* concerned that even with final adoption of our recommendations below, the rule could impose significant compliance burdens

[1] The Roundtable is a national association that represents 100 of the largest integrated financial services companies providing banking, insurance, investment products, and other financial services to American consumers. Roundtable member companies provide fuel for America's economic engine, accounting directly for $65.8 trillion in managed assets, $1 trillion in revenue, and 2.4 million jobs. BITS is the technology division of the Roundtable, leveraging intellectual capital to address issues at the intersection of financial services, operations and technology. BITS focuses on strategic issues where industry cooperation serves the public good, such as critical infrastructure protection, fraud prevention, and the safety of financial services.

on financial institutions by increasing their role in policing illegal activities, determining whether a transaction is illegal, or by imposing ambiguous compliance requirements that could be subject to wide variations in interpretation by regulators and law enforcement agencies. The statute and the proposed rule expand the role of financial institutions to police laws that are more appropriate for law enforcement agencies.

Below we offer specific comments on the provisions designed to:

- Clarify the definition of "unlawful Internet gambling" and "becoming aware";
- Clarify monitoring requirements;
- Strengthen Safe Harbor provisions;
- Clarify "blocking" to avoid confusion with Office of Foreign Assets Control ("OFAC");
- Clarify expectations of financial institutions to maintain a list of illegal gambling entities;
- Clarify how regulators will enforce the rule; and
- Extend the implementation deadline to account for the time it will take financial institutions, payments organizations and others to develop rules and modify systems that will be necessary to comply with final requirements.

Clarify the Definition of Unlawful Internet Gambling

The proposed rule contains several terms and compliance requirements that are too vague and open to interpretation. Unless these terms and requirements are clarified, it will be extremely difficult and costly for financial institutions to comply. This ambiguity could be a significant problem both in how financial institutions interpret the requirements and how financial regulators would enforce these requirements.

In particular, the Roundtable and its member financial institutions are very concerned that the definition of "unlawful Internet gambling" is so vague that participants in designated payment systems will be unable to determine how to comply with the proposed regulations.[2] Greater clarity is needed regarding what constitutes "unlawful Internet gambling" given conflicts in the positions advanced by the Departments of Justice and Treasury.[3] The proposed rule states that nothing in this regulation is intended to block an activity that is excluded from the definition of an intrastate, tribal and horseracing. The preamble of the rule only mentions these as examples but does not mention the entire population of lawful Internet gambling. This imposes a significant burden on financial institutions to determine what is legal versus illegal. As discussed further below, we believe the government should provide financial institutions with information on what is deemed legal and illegal. Thus, the agencies need to clarify if the rule applies to all gambling transactions or to only those not involved in intrastate, intratribal, and interstate horseracing transactions. Unless this is clarified, financial institutions will be

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[2] Proposed section ___.2(t) defines "unlawful Internet gambling" as placing, receiving, or transmitting a bet or wager by means that involves the use of the Internet "where such bet or wager is unlawful under any applicable Federal or State law in the State or Tribal lands in which the bet or wager is initiated, received, or otherwise made. . . ." The Federal Register notice states that the Agencies did not refine this definition because "[t]he Act focuses on payment transactions and relies on prohibitions on gambling contained in other statutes . . . . Further, application of some of the terms used in the Act may depend significantly on the facts of specific transactions and could vary according to the location of the particular parties to the transaction or based on other factors unique to an individual transaction."

[3] See November 14, 2007 discussion by representatives of the Department of the Treasury and Department of Justice before the House Judiciary Committee's hearing on establishing consistent enforcement policies in the context of online wagers. http://judiciary.house.gov/oversight.aspx?ID=396

left to determine on their own whether and which state or federal laws on gambling apply to a particular transaction.

Overall, the rule does not provide adequate detail on the policies and procedures financial institutions must have in place to comply with the proposed rule. Financial institutions need to know if a transaction is restricted if they only have information on the specifics of the transaction, location of the transaction taking place, and legality of the transaction. There are numerous examples of how this could play out given the location of an individual placing a bet, eligibility of the individual making the bet, the location of the entity processing the bet, and the location of the technology that may process the bet.

The result of the definition's lack of specificity is that participants in designated payment systems are left to determine without adequate information whether state or federal anti-gambling laws apply to a particular transaction. We are concerned that it is not possible for financial institutions to design policies and procedures to identify and block or otherwise prevent or prohibit restricted transactions. The formats used by most payment systems do not provide banks with the information such as the location of the person placing a bet that they would need in order to determine whether a transaction is related to "the participation of another person in unlawful Internet gambling" and is thus a restricted transaction within the meaning of proposed section ___.2(r).

As a practical matter, we believe that there will unlikely be any unlawful Internet gambling *businesses* but only unlawful Internet gambling *transactions*. Businesses that engage in unlawful Internet gambling transactions also will likely engage in lawful transactions that are not prohibited by the proposed regulations and for which there is no reliable safe harbor.

The Agencies' decision not to further define unlawful Internet gambling places banks and other financial transaction providers subject to the regulations in a very difficult position. They cannot know if a transaction is restricted unless they have in hand specifics of the transaction that in almost all instances they will not have. We recognize that the Agencies generally attempted to address this concern by limiting the application of the regulations in most cases to the participant in a designated payment system that has a relationship with the Internet gambling business and by limiting the obligation to having policies and procedures reasonably designed to prevent or prohibit restricted transactions in place. Further, we are concerned that financial institutions will face scrutiny and sanctions by regulators and law enforcement agencies that will come to the financial institutions after the fact with 20/20 hindsight.

We believe the regulations simply cannot work unless financial institutions and other financial transaction providers are given clear and specific rules. These rules should clarify: 1) the types of transactions that must be identified or blocked so financial institutions can determine on a real-time basis which transactions involve unlawful Internet gambling; <u>and</u> 2) a safe harbor for any transactions for which this determination is not absolutely clear at the time the transaction takes place.

We believe the Agencies need to *take one of two possible courses*. They can either define the term of unlawful Internet gambling in a way that allows the institutions to clearly identify restricted transactions, or, if they believe they cannot for the reasons set out in the Notice, then the Agencies must greatly broaden the exemptions set out in proposed section ___.4 to include at a minimum all participants in automated clearing house systems, check collection systems, and wire transfer systems. Additionally, the Agencies should also consider limiting the financial institution's liability in those cases in which a financial institution has a legal obligation to process a transaction under another law.

Clarify the Definition of Becoming Aware

The proposed rule also includes other definitions that could create significant confusion and inconsistent compliance standards. For example, the terms "due diligence", "reasonable due diligenee", and "becoming aware" (of when customers and merchants are involved in illegal Internet gambling) could be interpreted by regulators in different ways. We *urge* the Agencies to clarify what exactly the standard is when a bank "becomes aware" that a commercial customer has received an unlawful Internet gambling-related transaction. We believe that the appropriate and only reasonable standard is fact-based actual knowledge.

Clarify Monitoring Requirements

We *recommend* that the Agencies clarify in the final rule that the regulations do not create an additional monitoring requirement for entities that are subject to anti-money laundering monitoring and reporting obligations, and that participants in designated payment systems will be deemed to have satisfied their monitoring obligations under the regulations if they comply with their existing policies and procedures with respect to their anti-money laundering, anti-terrorist financing, OFAC-compliance, and suspicious-activity reporting obligations.

Financial institutions cannot do OFAC-type screening unless the government provides an OFAC-style list of names, which the Agencies have made clear they are reluctant to do. Payment systems and financial institutions also are unlikely to compile lists of unlawful Internet gambling businesses for the same reasons that the Agencies have given, together with the added considerations that they do not have the resources that the government has to do the investigations that would be necessary for compiling a list and because of concerns about possible legal liability to any entity that is mistakenly placed on a list.

The proposed rule places the onus on financial institutions to know the purpose and legality of payments. Since gambling laws are geographically based, financial institutions would need to determine where the customer is located when conducting in gambling activities and where computers and other equipment to process the transaction are located.

For example, the use of the Internet raises challenges in that data is transmitted across state and international lines. Further, payments providers do not have policies and procedures to identify and thus prevent restricted transactions. The transaction codes that merchants and financial institutions use are not designed to differentiate legal versus illegal Internet gambling transactions. For example, the current ACH operating rules do not provide a standard entry class code to identify internet gambling. There is the potential that entities such as overseas hotels and casinos may try to mask illegal Internet gambling payments as charges for a hotel room or other service. Thus merchants are in a much better position to identify an illegal gambling payment and monitor it. This raises questions as to how financial institutions would distinguish between those types of charges. In this case, there is a risk that financial institutions would misclassify a payment as illegal and thus be exposed to liability. We also believe that "monitoring of websites to detect unauthorized use of the relevant card system, including its trademark" is inappropriate to include in a financial institution's monitoring activity. For all these significant reasons, we *urge* the Agencies to modify the proposal in order to reduce the policing requirements currently imposed on financial institutions and creditors.

Strengthen Safe Harbor Provisions

As the Agencies point out, given the difficulty in defining what is unlawful, any policies and procedures developed by designated payment systems participants would probably prevent many lawful transactions. Consequently, it is critical that designated payment systems participants be protected against third party actions from legitimate businesses that are blocked pursuant to the policies and procedures adopted by those participants to meet their obligations under the Act and regulation. Our members *support* the "overblocking" provision in the Proposed Regulation and the Agencies' discussion of this provision in the Supplementary Information, which makes clear that the Safe Harbor in Section _.5(c)(3) is intended to protect any person that identifies and prevents a transaction pursuant to its own policies and procedures developed in accordance with the Proposed Regulation, even if that transaction is not illegal. This would allow designated payment systems participants to develop and implement policies and procedures that are flexible and workable so long as they are "reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions", even if they sometimes result in the prevention of legal transactions.

The proposed rule offers protection against third party actions if a "person is a participant in the designated payment system and blocks or otherwise prevents the transaction in reliance on the policies and procedures of the designated payment system", but does not specifically include persons who rely on their own policies and procedures in blocking a transaction. In this instance, the Roundtable urges the Agencies to interpret the preceding clause, "that such person reasonably believes to be a restricted transaction" as including blocking a transaction based on reliance on polices and procedures that are reasonably designed to block restricted transactions. This would clarify that financial institutions cannot be expected to scrutinize every single transaction separately from reliance on their polices and procedures. Additionally, this would benefit cases of wire transfers, ACH, and check processing, where the system will likely not have its own policies and procedures on which the financial institution can rely.

The Agencies should also clarify whether financial institutions have liability on restricted transactions. Given the way the proposed rule is written, financial institutions face a fundamental challenge of balancing lawful transactions including lawful intrastate and interstate gambling transactions versus illegal transactions. This is particularly of concern because of the lack of current codes to differentiate types of payments and technological means for transmitting payments. As a result, the Roundtable *recommends* that the Agencies take a closer look at these provisions of the proposed rule and clarify a financial institution's duty both for new or existing customers and for intrastate and interstate transactions.

Some members are concerned about their liability for processing restricted transactions that they are not aware are restricted. If a financial institution has put into place requisite polices and procedures, but are misinformed by the correspondent banks as to the nature of the transaction of the business involved, financial institutions may be held liable despite their best efforts to comply with the law. If a U. S. financial institution is unable to give clear direction to its foreign correspondents regarding what constitutes a prohibited Internet gambling transaction, it will be impossible to effectively limit the correspondents' monitoring of these transactions so that they are not inadvertently sent through their accounts at U. S. financial institutions. It also may result in financial institutions to notify correspondents and that in order to comply with this regulation the financial institution may have to prevent transactions or re-consider accepting transactions from correspondents altogether. As such, the Roundtable recommends that the Agencies delete the requirement that foreign correspondent banks

must agree to contract clauses restricting unlawful transactions, especially since these unlawful transactions are not clearly defined in the proposed regulations.

Additionally, the Roundtable *recommends* that the Agencies look at the issue of using credit cards issued on home equity credit lines to do Internet gambling transactions. This issue is not identified in the proposed rule. Additionally, under the Truth in Lending Act ("TILA") and Regulation Z, creditors are only permitted to prohibit advances on home equity credit lines for reasons specified in TILA and Reg Z.[4] There is no exception in Reg Z or TILA for blocking a gambling transaction on a home equity credit line. As a result, financial institutions receive complaints on claims from customers who do not think these transactions should have been blocked as well as claims that the financial institutions should have blocked the transactions when there are losses based on some illegality theory. Thus, in addition to resolving the potential conflict with TILA, the Agencies must *create a safe harbor* on this credit card use.

Clarify "Blocking" to Avoid Confusion with OFAC

The proposed regulations use the term "block" to describe the actions that financial institutions and others must take with respect to restricted transactions. This term is confusing because of the way it is used in the OFAC regulations. When OFAC uses that term it means that a bank that receives a transaction involving a blocked party must not only cease processing the transaction, it must pay the amount of the transaction into a blocked account so the blocked party is denied the use of the funds. We *recommend* that the final regulations contain a definition of "block" that makes it clear that a financial institution blocks a transaction when it rejects the transaction and returns any payment that the financial institution has received in respect of the transaction. The final regulation should clarify that there is no requirement that a financial institution freeze the amount of a prohibited transaction and pay the amount into a frozen account.

Clarify Requirements for Maintaining a List of Illegal Gambling Entities

The Agencies correctly anticipate the costs of maintaining a list of illegal gambling entities, which includes gathering and updating the information, providing a legal analysis, and assuming legal liability. Developing and maintaining such a list would be a significant compliance burden for each institution. As such, the Roundtable believes if Government expects financial institutions to develop and maintain a list, then the Government is far better suited to maintain such a list since it can serve as the central database for all financial institutions to use. If such a list were maintained, arguably, it should include domestic and offshore entities. Of course, there is precedent in that the Treasury Department currently maintains lists that financial institutions are required to check under OFAC. As a public policy matter, we question whether the cost of maintaining a list is the best or most appropriate use of public or private resources.

Clarify How Regulators Will Enforce the Rule

The Roundtable believes it is unclear as to how financial institutions and regulators would enforce the rule given that there are undefined penalties for non-compliance. It is unclear whether fines would be assessed by each of the regulators or by Treasury and whether fines will be administered in case of a breach. As noted above, we *recommend* that the Agencies emphasize that financial institutions may rely on existing monitoring systems (e.g., Anti-Money Laundering) and not develop new systems.

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[4] See section 226.5b(f)(3)(vi) of Reg Z.

Further, we *urge* the regulators to apply risk-based and consistent procedures across different charter types should the regulators determine that examination procedures are necessary.

The proposed rule raises the specter of financial institutions acting as the judge and jury and thus summarily assessing fines against a customer. We do not believe it is appropriate for the government to require financial institutions to impose fines on customers. We *urge* the Agencies to *clarify expectations* and differentiate requirements such as the OFAC rules which require financial institutions to freeze funds and place them in escrow.

Extend the Implementation Deadline

The proposed rule states that the "final regulations take effect six months after the joint final rules are published." We believe a six month implementation deadline is unrealistic because of the time it will take financial institutions and the various payment organizations to develop policies and procedures and to modify systems. It takes considerable time for payments organizations to change their policies and procedures once a final rule is in place. Therefore, the Roundtable *recommends* that the Agencies extend the implementation deadline to no less than 24 months after issuance of the final rule or 12 months after the payments associations have completed implementation of its changes in policies and procedures.

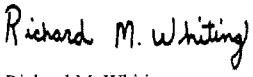
Conclusion

In conclusion, the Roundtable appreciates the efforts by the Agencies to minimize the compliance burden given the language in the statute, but we urge the Agencies to take the following steps to further minimize the compliance burdens on financial institutions:

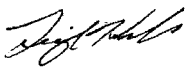
- Clarify the definition of "unlawful Internet gambling" and "becoming aware";
- Clarify monitoring requirements;
- Strengthen Safe Harbor provisions;
- Clarify "blocking" to avoid confusion with OFAC;
- Clarify expectations of financial institutions to maintain a list of illegal gambling entities;
- Clarify how regulators will enforce the rule; and
- Extend the implementation deadline to account for the time it will take financial institutions, payments organizations and others to develop rules and modify systems that will be necessary to comply with final requirements.

The Roundtable looks forward to working with you as you continue to examine this important issue. If you have any questions or comments on this matter, please do not hesitate to contact us or John Carlson, Senior Vice President of BITS or Melissa Netram, Director of Regulatory and Securities Affairs for the Roundtable at 202.289.4322. Thank you for your consideration.

Sincerely,



Richard M. Whiting
Executive Director and General Counsel
The Financial Services Roundtable



Leigh Williams
President
BITS

AMERICANS for TAX REFORM

Grover G. Norquist
President

1920 L Street NW
Suite 200
Washington, DC
20036
T: (202) 785-0266
F: (202) 785-0261
www.atr.org

April 1, 2008

To: all Members of the Financial Services Committee
Re: Hearing on UIGEA Regulations

Dear Financial Services Committee Member,

On Wednesday, April 2, 2007, the Subcommittee on Domestic and International Monetary Policy will hold a hearing entitled "Proposed UIGEA Regulations: Burden Without Benefit." On behalf of the members of Americans for Tax Reform, I am writing to convey our concerns about the proposed UIGEA regulations.

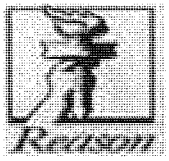
As you may know, during consideration of UIGEA, ATR voiced its concerns about deputizing banks and payment systems and turning them into the enforcers of morality on the Internet. However, if the government is to take this extraordinary step, it should be done in a minimally intrusive manner.

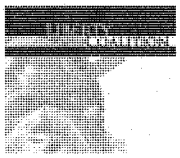
I am attaching a copy of the comment letter that ATR, along with several other pro-freedom groups, filed during the comment period on this proposed rule. We remain concerned about the implications of this rule in terms of personal freedom, personal privacy and regulatory burden on the banking industry, regulatory clarity and international trade.

I encourage the committee members to vigorously exercise their oversight authority with respect to these proposed regulations, and to press the regulatory agencies to modify the proposed rule to make it clearer and less burdensome.

Sincerely,

Grover Norquist
President,
Americans for Tax Reform





December 10, 2007

The Honorable Jim Nussle
Director, Office of Management and Budget
Eisenhower Executive Office Building
1650 Pennsylvania Ave., NW
Washington, DC 20503

Dear Director Nussle,

We are a coalition of organizations concerned with individual rights and freedoms representing hundreds of thousands of individual members from every walk of American life. We are writing today with our concerns over the implementation of the Unlawful Internet Gambling Enforcement Act of 2006.

The rules governing the UIGEA could have dire unintended consequences if not done with the utmost care.

The proposed regulation offers no clear-cut definition of what constitutes "gambling," therefore, if the regulations governing the UIGEA are written too broadly it could force credit card institutions into a situation where they would be blocking legitimate online transactions in order to protect themselves from criminal penalties and have unintended consequences that harm consumers.

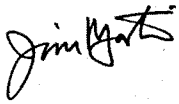
Further, we are concerned that attempts to enforce this law would open up individuals to a violation of their privacy as government officials or financial institutions comb through all manner of online transactions seeking confirmation or refutation of suspicion of now illegal online gambling charges. Financial institutions could find themselves in a situation where they block lawful transactions simply as a defense mechanism against allowing "illegal" transfers to go through.

You can see how vaguely written rules could open up a Pandora's Box of confusion.

The rule implementing this law should circumscribe "gambling" in as limited way as possible. The distinction between what constitutes a violation of the UIGEA and what does not must be made clear so as to avoid any situation where an individual's rights might be infringed upon in the name of enforcement of an ambiguously written statute. We would therefore urge that you direct the agencies to refrain from finalizing the proposed rule until they have completed a separate proceeding to clarify, on a state-by-state basis, what transactions constitute "unlawful Internet gambling" for the purpose of the rule and the Act."

Sincerely,

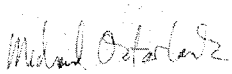
Grover Norquist
President,
Americans for Tax Reform



James L. Maritn
President,
60 Plus Association

Michael Flynn
Director of Government Affairs
Reason Foundation

Doug Bandow
Vice President for Policy,
Citizen Outreach Project



Michael D. Ostrolenk
National Director,
Liberty Coalition

Derek Hunter
Executive Director,
Media Freedom Project

CHAMBER OF COMMERCE
OF THE
UNITED STATES OF AMERICA

R. BRUCE JOSTEN
EXECUTIVE VICE PRESIDENT
GOVERNMENT AFFAIRS

1615 H STREET, N.W.
WASHINGTON, D.C. 20062-2000
202/463-5310

April 1, 2008

The Honorable Luis V. Gutierrez
Chairman
Subcommittee on Domestic and International
Monetary Policy, Trade
and Technology
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

The Honorable Ron Paul
Ranking Member
Subcommittee on Domestic and International
Monetary Policy, Trade
and Technology
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Dear Chairman Gutierrez and Ranking Member Paul:

The U.S. Chamber of Commerce, the world's largest business federation representing more than three million businesses of every size, sector, and region, applauds the Subcommittee on Domestic and International Monetary Policy, Trade, and Technology's decision to hold an oversight hearing on the proposed regulations issued pursuant to the Unlawful Internet Gambling Enforcement Act (UIGEA).

During congressional consideration of the UIGEA, the Chamber voiced its concerns that the statute could become confusing or burdensome to businesses affected by the regulations. Having now seen the proposed regulations issued by the Department of the Treasury (Treasury) and the Board of Governors of the Federal Reserve (the Fed), the Chamber remains concerned and hopes your hearing will help address this.

1. The proposed rule does not define "restricted transaction."

One problem with the proposed rule is its failure to clarify what constitutes a restricted transaction for the purpose of the rule. In several places in the preamble to the proposed rule, Treasury and the Fed cite the difficulty of making that determination. Instead, the proposed rule imposes the burden on banks and payment processors. Differences in interpretation of the Wire Act (18 U.S.C. Section 1084) between the Department of Justice and the courts account for part of this. Finally, there is considerable confusion about the meaning of the exemption provisions, particularly the exemption for wagers conducted pursuant to the Interstate Horseracing Act (IHA). For instance, it is not clear from which states it is legal to take bets under the IHA.

In its previously filed comments, the Chamber proposed that Treasury and the Fed resolve these questions in a formal rulemaking proceeding with an Administrative Law

Judge (ALJ) before having the proposed rule take effect, and the Chamber continues to believe that this is the best way to provide clarity to the regulated community.

2. The proposed rule does not comply with the Regulatory Flexibility Act.

The U.S. Small Business Administration (SBA) has filed comments to the effect that the proposed rule fails to comply with the Regulatory Flexibility Act in that the proposed rule's Initial Regulatory Flexibility Analysis (IRFA) failed to adequately assess the regulatory burden on small businesses. In their letter, SBA asserts that, in order to comply with the law, Treasury and the Fed should perform a more complete IRFA and solicit public comments on it before seeking to finalize the rule. As strong supporters of small business and the Regulatory Flexibility Act, the Chamber supports SBA's position.

3. The proposed rule could strain the international banking system.

The Chamber is concerned about the burden posed on the international relationships of U.S. banks. Although the extent of the burden is not clear under the proposed rule, it appears that U.S. banks would have to perform due diligence, not only with respect to each of their relationships with non-U.S. financial institutions, but with respect to every relationship of those institutions, possibly resulting in multiple degrees of know-your-customer responsibility. The rule would also compel U.S. banks to require all of their foreign partners and all of those banks' partners to refrain from providing merchant services to companies that might be accepting "illegal Internet wagers"—which neither the proposed rule nor UIGEA define—even though those companies are operating legally in the jurisdictions where they are situated.

This effort to use access to the U.S. banking system as a mechanism to leverage enforcement of U.S. laws by foreign banks could prove to be a strain on the international banking system. Foreign banks comply with these sorts of requirements in the course of fighting terrorism, but it is unclear whether they would be as accommodating with respect to Internet waging. For example, the U.S. stance on Internet gambling has already caused the U.S. to lose one WTO case, and to undertake the unprecedented step of trying to withdraw a WTO obligation in response to an adverse decision. As strong supporters of the U.S. banking system and of international trade, the Chamber is concerned that the proposed UIGEA rule could exacerbate this situation.

4. The proposed rule needs to be considered in the context of the broader regulatory burden on U.S. financial institutions.

There are many areas where banks are pressed into the service of the federal government. From helping to track the finances of terrorists and organized crime syndicates, to community lending, banks are already carrying the substantial burden of many other laws, which are much more directly linked to the banks' underlying business than is the UIGEA. The Chamber suggests that the regulatory burden imposed by this rule should reflect that reality.

To be clear, the Chamber understands that Treasury and the Fed face a challenge in trying to prevent millions of Americans from gambling online. In the UIGEA, Congress chose to impose this burden on banks and payment processors. If the federal government is going to take this step, it must provide as much clarity as possible and should promulgate rules that reflect the broader regulatory burden already placed on U.S. financial institutions by other laws and regulations. The proposed rule succeeds at neither.

Again, thank you for holding this hearing.

Sincerely,

Bruce Josten

Cc: Members of the Subcommittee on Domestic and International Monetary Policy, Trade, and Technology

Center for Regulatory Effectiveness
Suite 500
1601 Connecticut Avenue, N.W.
Washington, DC, 20009
Tel: (202) 265-2383 Fax: (202) 939-6969
secretary1@mbsdc.com www.TheCRE.com

March 31, 2008

The Honorable Luis V. Gutierrez, Chairman
Subcommittee on Domestic and International
Monetary Policy, Trade, and Technology
Rayburn House Office Building
Washington, DC 20515

The Honorable Ron Paul, Ranking Member
Subcommittee on Domestic and International
Monetary Policy, Trade, and Technology
Rayburn House Office Building
Washington, DC 20515

Re: Congressional Request for Information on the UIGEA Rulemaking

Dear Representatives Gutierrez and Paul:

I am writing in response to your request for information regarding the importance of the Paperwork Reduction Act and the Regulatory Flexibility Act with respect to the UIGEA rulemaking.

Before discussing the central role of these statutes in governing the rulemaking process, I would like to provide you with some background information about myself. I worked for five Administrations, both Democratic and Republican, for four of these I served as a policy official in OMB. With respect to the PRA, I was one of the officials in the Administration who worked with Congress on passage of the Act. I was also the first career official in charge of the PRA's implementation.

Paperwork Reduction Act

In drafting the PRA, Congress recognized the importance of having a structured system for reviewing the paperwork burdens associated with proposed rules. Of particular concern with respect to the UIGEA proposed rule are the unfunded mandates the proposal would place on the banking system. Moreover, these mandates go far beyond the usual reporting and recordkeeping burdens to include such fundamental issues as interpreting federal and state laws and renegotiating international business agreements. Not surprisingly, many of the proposed burdens would fall on small businesses.

We are pleased that, in response to the agencies' request for OMB approval under the PRA, OMB responded by stating that:

> *OMB is withholding approval at this time. Prior to publication of the final rule, the agency should provide a summary of any comments related to the information collection and their response, including any changes made to the ICR as a result of comments.*

Although this action by OMB is not a final agency action, it does constitute the views of OMB at the time of its review, February 1, 2008, namely that OMB expects Treasury to give serious consideration to the public's comments on the ICR prior to submitting the revised document to OMB for final review. To assist Treasury, CRE provided the agency, in response to their request for comments on the ICR, a ten page submission detailing specific examples of how the ICR failed to comply with the requirements of the PRA including:

1) Not identifying many of the types of paperwork burdens that would be required by the proposed rule;

2) Not evaluating the burden on banks of determining and disclosing to third-parties the restricted transactions that must be blocked; and

3) Not estimating the costs associated with each of the paperwork-related burdens.

Regulatory Flexibility Act

With respect to the Regulatory Flexibility Act, the US Small Business Administration's Office of Advocacy explained to the Treasury Department and Federal Reserve System, that the agencies "have not analyzed properly the full economic impact of the proposal on small entities as required by the Regulatory Flexibility Act (RFA)." Types of small business adversely impacted by the proposed rule include money transmitting businesses, such as those represented by the Money Services Round Table, as well as small banks, thrifts and credit unions.

The SBA's comments concluded by stating:

> *Advocacy encourages the agencies to prepare and publish for public comment a revised IRFA to determine the full economic impact on small entities; identify duplicative, overlapping or conflicting regulations; and consider significant alternatives to meet its objective while minimizing the impact on small entities before going forward with the final rule.*

Conclusion

Both of the agencies that Congress charged with overseeing enforcement of laws to protect small businesses and the general public in the rulemaking process have concluded that the proposed rule is critically deficient.

Therefore, CRE concludes that there are systemic flaws in this rulemaking that can only be rectified, as required by statute, by a re-proposal of the rule for public comment.

Sincerely,

/s/
Jim Tozzi
Member, Board of Advisors

NOTICE OF OFFICE OF MANAGEMENT AND BUDGET ACTION

Date 02/01/2008

Department of the Treasury
Departmental Offices
FOR CERTIFYING OFFICIAL: Michael Duffy
FOR CLEARANCE OFFICER: Robert Dahl

In accordance with the Paperwork Reduction Act, OMB has taken action on your request received 09/11/2007

ACTION REQUESTED: New collection (Request for a new OMB Control Number)
TYPE OF REVIEW REQUESTED: Regular
ICR REFERENCE NUMBER: 200709-1505-001
AGENCY ICR TRACKING NUMBER:
TITLE: Prohibition on Funding of Unlawful Internet Gambling

OMB ACTION: Comment filed on proposed rule
OMB Number: 1505-0204

EXPIRATION DATE: Not Applicable DISCONTINUE DATE:

COMMENT: OMB files this comment in accordance with 5 CFR 1320.11(c). This OMB action is not an approval to conduct or sponsor an information collection under the Paperwork Reduction Act of 1995. This action has no effect on any current approvals. If OMB has assigned this ICR a new OMB Control Number, the OMB Control Number will not apfear in the active inventory. For future submissions of this information collection, reference the OMB Control Number provided. Pursuant to 5 CFR 1320.11(c), OMB files this comment on this information collection request (ICR). In accordance with 5 CFR 1320, OMB is withholding approval at this time. Prior to publication of the final rule, the agency should provide a summary of any comments related to the information collection and their response, including any changes made to the ICR as a result of comments.

OMB Authorizing Official: Kevin F. Neyland
Deputy Administrator,
Office Of Information And Regulatory Affairs

Written Testimony of

Marcia Z. Sullivan

on behalf of

Consumer Bankers Association

To the House Financial Services Subcommittee on Domestic and International Monetary Policy, Trade, and Technology

"Proposed UIGEA Regulations: Burden without Benefit?"

United States House of Representatives

April 2, 2008

Introduction
The Consumer Bankers Association ("CBA") is pleased to submit written comments on the proposed regulations ("Proposal") to Unlawful Internet Gambling Enforcement Act ("UIGEA"), issued by the Board of Governors of the Federal Reserve System and the Department of Treasury (the "Agencies"). The CBA is the recognized voice on retail banking issues in the nation's capital. Member institutions are the leaders in consumer, auto, home equity and education finance, electronic retail delivery systems, privacy, fair lending, bank sales of investment products, small business services and community development. The CBA was founded in 1919 to provide a progressive voice in the retail banking industry. The CBA represents over 750 federally insured financial institutions that collectively hold more than 70% of all consumer credit held by federally insured depository institutions in the United States.

Overview
CBA and its members have witnessed the increasing use of the U.S. payment system to enforce various legal requirements imposed by legislation, often not directly related to banking. This is placing an unnecessary stress on the system and has grown to a point that it is a serious burden on banks and other payment system participants. The UIGEA is one more example of such an obligation. The lack of clarity in the Proposal's definitions make it even more burdensome and even less manageable for those who must comply, and ultimately creating a system that will not accomplish its objectives.

We will address our concerns primarily through a discussion of the following terminology used in the Proposal:

- Unlawful Internet Gambling
- Knowledge
- Blocking, Prevention, Prohibition of Transactions
- Reasonable Standard

Clarification of Terminology

Unlawful Internet Gambling

The absence of a clear delineation of responsibilities of financial institutions will make smooth implementation of the anti-gambling policy within the payment system an impossibility. A clear delineation of the responsibilities of financial institutions would be absolutely necessary in order to avoid costly and counterproductive compliance problems, as well as liability that could arise from any violation of federal law, pursuant to state unfair and deceptive practices acts. For example, the term "Unlawful Internet Gambling", as defined in section ___.2 of the Proposal, is unclear. As defined, that phrase covers placing, receiving, or transmitting a bet or wager by means that involve the use of the Internet "where such bet or wager is unlawful under any applicable Federal or State law in the State or Tribal lands in which the bet or wager is initiated, received, or otherwise made . . ."By incorporation of other statutes, which may be amended from time to time, into a final rule, the proposal presents a complex and ever-changing compliance challenge. However, the complexity inherent in this directive is not limited to the

dynamic nature of state and federal law. Illegality may depend upon the location of the bettor, who would not be restricted to placing bets while at his home address, but could do so while visiting a location where such bets are legal. Tracking this series of unknowns is not technologically possible.

While the Agencies have hesitated to create a list of organizations engaged in unlawful Internet gambling (on the style of OFAC lists), it may nevertheless be the best approach to assign a government agency the responsibility of creating a list that would be based upon an interpretation of various state and federal gambling laws and a review of the activities of the entities that may be involved in these kinds of transactions, at least as applied to ACH, check and wire-transfer transactions. For other transactions, while it is a difficult, time-consuming task, an exclusive list of entities from which transactions must be blocked would facilitate compliance. Responsibility to go beyond the list must be definitively eliminated.

In order to create an adequate compliance system to block "unlawful Internet gambling," at least for ACH, check and wire-transfer transactions, banks would need specific and well-defined rules regarding the types of transactions that must be identified or blocked as well as protection from liability for any transaction in which the legality at the time of the transaction is unclear. The standards and definitions currently in the Proposal fall far short of this goal. This problem is exacerbated when banks attempt to instruct their correspondents on the monitoring of Internet gambling transactions, as also contemplated in the Proposal (see section __.6(b)(2) and (d)(2)). It may be that the only real leverage a bank has over its correspondent to require compliance with monitoring requirements is to terminate the relationship.

There are also similar problems in card network transactions which include credit, debit, prepaid, and stored value cards. The Agencies indicate that the coding through the card network transactions system is firmly established through merchant codes that identify their categories of business, but problems ensue if businesses have not been properly coded. Businesses may also run ancillary operations through companies that mask illegal operations running through a legitimate business model. Ultimately, the system relies on the integrity of the business to identify itself as an illegal gambling operation, and we do not believe will be effective in this regard.

Knowledge

The Proposal in section ___.6, contains a list of policies and procedures to identify and block or otherwise prevent or prohibit restricted transactions for each type of non-exempt participant in a designated payment system. The standards applicable to each of the policies fall into one of two categories: the participant is required to have in place procedures to be followed if the participant "becomes aware" that a customer has received a restricted transaction; or the participant must have procedures to be followed with respect to a foreign or other recipient that is "found to have" received payments or otherwise engaged in transactions that are restricted transactions. These standards lack clarity and will be extremely problematic in the development of a credible compliance plan.

Blocking, Prevention, Prohibition of Transactions

The requirement to block, prevent or prohibit unlawful Internet gambling transactions, a fundamental concept in the Proposal, is lacking in definition. Is this blocking responsibility the same prescribed action set forth in anti-money laundering regulations like those followed under programs administered by the Treasury Department's Office of Foreign Assets Control ("OFAC"); or does it carry a different connotation? Does the Proposal envision a procedure that includes not only cessation of processing, but also (similar to OFAC procedures) payment of the amount of the transaction into a blocked account in order to preclude use of the funds? This requirement may not be consistent with other types of mandated blocking of transactions.

Reasonable Standard

The frequent use of the term "reasonable" in the Proposal presents a subjective standard that will be vulnerable to criticism, not only by regulators, but also by plaintiffs' attorneys seeking to explore opportunities for litigation possibly under state consumer protection laws. This is not a plea to allow unreasonable behavior, but merely a request for consideration of what compliance professionals will be required to set as standards for operating within the law. Section ___.5 (a) of the Proposal, for example, requires a financial institution to establish and implement written policies and procedures "reasonably" designed to effect compliance with the rule. Section ___.5 (b) (1) of the Proposal then allows a financial institution to rely on "written policies and procedures of the designated payment system that are *reasonably* designed" to comply with the blocking requirements of the Proposal (emphasis mine). Who will determine if a financial institution has acted reasonably in relying on the policies and procedures of a designated payment system; how can a financial institution know if these same policies and procedures were "reasonably designed" to effect compliance (i.e., has the payment system taken the steps required in the rule and what verification of this due diligence is needed); what are the standards for making the determinations that the payment system has acted appropriately in designing its systems reasonably?

The so-called "safe harbor" provision (___.5 (c)) further requires a determination that a person *reasonably* believes that a blocked transaction is a "restricted transaction" as one qualification for "safe harbor" treatment. This third level of reasonableness will create havoc in our attempts to develop testable compliance plans, not only because of the vagueness of the standard, not only because it is the third level of reasonableness required, but also because the text now shifts from reasonable *procedures* on a *systems* level to a determination of reasonableness on a *transaction* level.

Conclusion

Compliance officers expend substantial efforts to construct plans that are logical and, to the extent possible, internally consistent with other, similar requirements, like anti-money laundering regulations, and employ objective metrics to ensure proper application of rules. The rules for blocking illegal transactions should be distinguished from those in place for other proscribed transactions, and that vague standards like "reasonableness" either be deleted or described in terms of objective standards that can easily be implemented by our compliance personnel and examined by our regulators. Banks face the possibility of disrupted transactions and liability flowing from the lack of clarity in the Proposal.

For the reasons discussed above, we believe that the Proposal, in its current form, is unworkable and cannot be implemented in a way that will produce measurable compliance in an objective fashion.

National Association of Federal Credit Unions
3138 10th Street North • Arlington, Virginia • 22201-2149
(703) 522-4770 • (800) 336-4644 • Fax (703) 522-2734

Fred R. Becker, Jr.
President and CEO

April 1, 2008

The Honorable Luis V. Gutierrez
Chairman
Financial Services Subcommittee on Domestic
and International Monetary Policy, Trade and Technology
United States House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Gutierrez/Mr. Chairman

I am writing on behalf of the National Association of Federal Credit Unions (NAFCU) the only trade organization exclusively representing the interests of our nation's federal credit unions, regarding the hearing entitled "Proposed UIGEA Regulations: Burden without Benefit?" NAFCU welcomes this important hearing and the opportunity to share our views regarding the proposed Internet gambling regulations.

NAFCU commends efforts to promulgate rules for the Unlawful Internet Gambling Enforcement Act of 2006. We, however, continue to have concerns regarding the detrimental effects implementation and compliance with these regulations would have upon federal credit unions. Many of the proposed rules would essentially have the effect of turning financial institutions into law enforcement apparatuses instead of financial service organizations. Make no mistake, the credit union industry remains firmly committed to helping safeguard the American financial system from threats posed by illicit and unlawful activity, especially terrorist financing and money laundering. NAFCU is, however, concerned with the increasing degree of accountability that financial institutions are shouldering in policing unlawful or immoral activities. NAFCU firmly believes that the primary responsibility of depository institutions is, and always should be, the safe and sound distribution of financial services and products and not the surveillance of consumers.

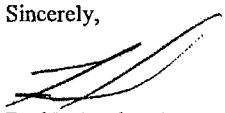
Specifically, the regulations call for financial institutions to identify and block transactions that fund illegal gambling activities. NAFCU supports section 5 of the proposal which clarifies that non-exempt participants do not have to "overblock" or prevent legal gambling transactions thus offering a safe harbor. There is, however, no

standardized system in place that would help these institutions easily identify bad actors. Furthermore, were a system in place, the proper maintenance of this tool would be cost prohibitive and an undue burden on financial institutions such as federal credit unions that have limited resources to conduct everyday operations. Therefore, NAFCU endorses the proposals contained in HR. 2046, the Internet Gambling Regulation and Enforcement Act, sponsored by the Financial Services Committee Chairman Barney Frank. This legislation would call for the licensing of potential internet gambling companies thus making it easier and more efficient to track lawful and unlawful internet gambling activities.

NAFCU believes that the six month period proposed by the agencies for final regulation to take effect is insufficient. In some cases, credit unions may be forced to rely on payment systems or other third party providers to institute the required policies and procedures to identify and block restricted transactions. Therefore, NAFCU recommends a minimum of 12 months from the date of publication in the *Federal Register* be provided to allow credit unions sufficient time to establish and fully implement required policies and procedures. Furthermore, NAFCU recommends a moratorium be placed upon the implementations of the proposed regulations until all the above mentioned concerns and possible solutions such as those mentioned in HR. 2046, can be fully considered.

We thank you for holding this important hearing and look forward to continuing to work with the Committee in finding ways to improve internet gambling regulations without burdening financial institutions. Please do not hesitate to contact me or NAFCU's Director of Legislative Affairs Brad Thaler at 703-522-4770 with any questions or concerns that you may have.

Sincerely,



Fred R. Becker, Jr.
President and CEO

Mr. Chairman -
We appreciate your consideration of our concerns!

cc: Members of the Subcommittee

Testimony of Rick Smith
Head of Government Affairs, Policy and Regulation
UC Group Limited
House Financial Services Committee
Subcommittee on Domestic and International Monetary Policy, Trade, and Technology

Proposed UIGEA Regulations: Burden without Benefit?

Wednesday, April 2, 2008, 10:00 a.m., 2128 Rayburn House Office Building

My name is Rick Smith, and I am the Head of Government Affairs, Policy and Regulation for UC Group Limited, a British payments processor specializing in providing services to reduce the risks of online activity for consumers, merchants, and the payments system generally. I have over 15 years experience as a government regulator in the gambling industry in Australia and New Zealand.

My testimony is intended to provide the Congress with a summary of some of the major deficiencies in the proposed Prohibition on Funding of Unlawful Internet Gambling[1] ("Proposed Regulation") issued by the Federal Reserve and the Department of Treasury ("Treasury") and which would implement provisions of the Unlawful Internet Gambling Enforcement Act of 2006 ("UIGEA").

UC Group believes that UIGEA, and the Proposed Regulation, is not the correct response to Internet gambling. Prohibition has historically never worked. UIGEA is an impractical and unworkable approach and also creates an unjustified burden on the financial sector institutions. The preferred course of action is to introduce a comprehensive regulatory regime such as that proposed under the Internet Gambling Regulation and Enforcement Act (H.R. 2046) introduced by Congressman Barney Frank (D-MA) and its companion bill the Internet Gambling Regulation and Tax Enforcement Act of 2008 (H.R. 5523), introduced by Congressman Jim McDermott (D-WA). Following an extensive review a regulatory approach has been adopted by another leading jurisdiction in the form of the United Kingdom. A robust regulatory regime is a sensible solution and one that provides protection for consumers, including the vulnerable and underage, ensures the integrity of the industry and collects government revenue that otherwise disappears off-shore as is the case with the current environment.

With specific regard to the Proposed Regulation, the UC Group believes that it is fatally deficient, including, but not limited to, the following major issues, along with additional issues that are specifically identified later in this comment:

(1) It fails to meet legal requirements expressly set forth in the text of UIGEA. These include provisions that require the regulations to protect against overblocking, as set forth in Section 5464(b)(4). These also include provisions that require the regulators to exempt designated payment systems from any requirement imposed under such regulations when it is not

[1] Prohibition on Funding of Unlawful Internet Gambling, 72 Fed. Reg. 56690 (Oct. 4, 2007) (to be codified at 12 C.F.R. § 233 and 31 C.F.R. § 132).

reasonably practical to identify and block, or otherwise prevent or prohibit the acceptance of, such transactions, as is set forth in Section 5464(b)(3).

(2) Its failure to identify which transactions are Restricted Transactions and which are not renders the Proposed Regulation so vague as not to provide sufficient notice to those affected by the regulation regarding their compliance obligations.

(3) It would impose costly, extremely burdensome requirements on designated payment systems and covered entities participating in those systems without providing the payment systems or their participants' adequate guidance to enable them to meet the obligations of the law. Notably, with regard to stored value cards and gift cards, it extends coverage to sectors not previously subject to regulations requiring them to identify purchasers, redeemers, or types of transactions, thus requiring those involved in initiating or redeeming payments involving those cards to develop entirely new policies, procedures, systems, and technologies at great cost.[2]

(4) It would create conflicting obligations in a variety of commercial banking relationships both domestically and internationally, as well as threaten to increase the costs to the United States arising from the WTO's finding that the U.S. application of its domestic Internet Gambling laws to foreign operators violated U.S. trade commitments.

(5) It is contrary to the public policy purposes set forth in UIGEA, because if implemented as written, the Proposed Regulation would drive Internet Gambling activity to payment systems not covered by the Proposed Regulation, thereby violating the intent of Congress to stop what is a defined as a "Restricted Transaction" under the Act.

(6) At both the technical and substantive levels, the Proposed Regulation does not meet the legal requirements of the Paperwork Reduction Act and the Regulatory Flexibility Act.

I. SUMMARY

- The Proposed Regulation does not provide guidance to financial institutions as to what types of Internet Gambling are legal and which are not, yet requires financial institutions to make this determination. Remarkably, the Proposed Regulation states that it would be too burdensome for the federal regulators to make this assessment, yet makes the express finding that it is not unduly burdensome for private sector entities – including small businesses – to do so. The requirement that private sector entities, rather than federal regulators, make judgments about what is and what is not illegal under federal and state law is inherently unreasonable. This is especially the case when such an assessment is central to both the purpose of UIGEA and the ability of the covered entities to meet their legal obligations under it. Covered entities cannot conduct "reasonable due diligence"

[2] The Proposed Regulation fails to even acknowledge the cost of such policies, procedures, systems and technologies for those involved in stored value cards, and gift cards, let alone factor such costs into the rule-making process as required by law. Studies undertaken for the Federal Reserve have found the Stored Value Card industry is growing rapidly, involves tens of millions of cards, and is to date essentially unregulated at the federal level. See Stored Value Cards: Challenges and Opportunities for Reaching Emerging Markets, A Working Paper for the Federal Reserve Board 2005 Research Conference, http://www.newyorkfed.org/regional/svc_em.pdf.

without knowing specifically what the federal regulators define to be a Restricted Transaction.[3] The Proposed Regulation must specify what types of gambling are "Restricted Transactions" and which are not, and the failure to do so makes it deficient.

- The Proposed Regulation creates a safe harbor for "overblocking," but none for "underblocking." The proposed overblocking safe harbor, in the absence of any counterpart for underblocking, will result in financial institutions engaging in substantial blocking of Internet Gambling transactions that are lawful, in disregard of UIGEA's express mandate that "transactions in connection with any activity excluded from the definition of unlawful Internet Gambling . . .are not blocked or otherwise prevented or prohibited by the prescribed regulations." Section 5364(b)(4). As a result, the Proposed Regulation is deficient.

- The Proposed Regulation would require a covered entity to take certain actions when it "becomes aware" that a customer is receiving restricted transactions. The Proposed regulation provides no definition or clarification as to what level of knowledge is required, creating a legal standard that is so vague and indefinite that those affected by the regulation cannot reasonably be expected to know when an action is actually required by the regulation, making the Proposed Regulation deficient. To correct this deficiency, the Proposed Regulation must define when a covered entity shall be deemed by regulators to "become aware" a customer is receiving restricted transactions.

- The Proposed Regulation's treatment of cross-border transactions and relationships threatens the relationship between U.S. financial institutions and other covered domestic entities and foreign financial institutions with which they have correspondent relationships, by requiring covered domestic entities to engage in intrusive inquiries into the policies and procedures of such foreign institutions relating to their handling of transactions that are lawful in those jurisdictions, as well as transactions that might be restricted. These provisions of the Proposed Regulation go beyond the regulatory requirements set forth in UIGEA, are overly broad and burdensome, and are not necessary to achieve the purposes of UIGEA.

- The Proposed Regulation would require those issuing and selling gift cards and all other forms of stored value cards to put into place mechanisms to prevent their use for restricted transactions, regardless of their value, without any threshold. This constitutes a gigantic expansion of the class of persons covered by the regulation, yet the Proposed Regulation fails to address the numbers of entities that would be covered under this provision, in violation of the Regulatory Flexibility Act, making the Proposed Regulation deficient.

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[3] "It is a basic principle of due process that an enactment is void for vagueness if its prohibitions are not clearly defined. Vague laws offend several important values. First, because we assume that man is free to steer between lawful and unlawful conduct, we insist that laws give the person of ordinary intelligence a reasonable opportunity to know what is prohibited, so that he may act accordingly. Vague laws may trap the innocent by not providing fair warning. Second, if arbitrary and discriminatory enforcement is to be prevented, laws must provide explicit standards for those who apply them. A vague law impermissibly delegates basic policy matters to policemen, judges, and juries for resolution on an ad hoc and subjective basis, with the attendant dangers of arbitrary and discriminatory application." *Grayned v. City of Rockford*, 408 U.S. 104 (1972).

- UIGEA grants the Agencies the authority to exempt certain restricted transactions or designated payment systems from any requirement imposed under such regulations, if the Secretary and the Board jointly find that it is not reasonably practical to identify and block, or otherwise prevent or prohibit the acceptance of, such transactions. Stored value cards and gift cards have not previously been subject to specific federal regulations requiring them to identify the purchasers, redeemers, or use of the cards, and each provide products to tens of millions of U.S. consumers, mostly on an anonymous basis and without systems that restrict use to particular purposes.[4] Moreover, there has been no finding that these products have meaningfully contributed to the facilitation of unlawful Internet Gambling. The costs of imposing the Proposed Regulation on stored value cards and gift cards would be substantial, and the benefit has not been shown to be significant. For this reason, the regulators should make use of the authority provided to them in UIGEA to exempt these types of products from any requirement imposed under the regulations.

- It is not reasonable for those issuing gift cards and other forms of small-value stored value cards that are sold anonymously to determine whether they will be used for Restricted Transactions. The Proposed Regulation should, at minimum, create an exclusion for gift cards and stored value cards below a reasonable dollar value from coverage, through the authority provided them in UIGEA.

- The Agencies provide explicit and detailed explanations of and justifications for their decision not to publish a list of Internet Gambling operators or websites, finding that the creation of such a list would be burdensome for the regulators, likely to be incomplete, subject to ready circumvention, and would require substantial administrative mechanisms to avoid the risk of due process violations. Yet the Proposed Regulation has the practical effect of requiring private sector entities through each covered payment system to create such a list. The same practical objections apply to a private sector list and this is exacerbated by the Proposed Regulation's failure to specify what types of gambling are illegal. Moreover, due process concerns are not obviated by shifting the burden to the private sector. The lists would be adopted by the private sector only as a consequence of the state action, embroiling boththe regulators, the covered payment systems and the covered entities in essentially identical litigation risks.

- The Proposed Regulation would impose liability on designated payment systems for failing to monitor for the improper use of the payment systems' trademark and take legal action against any misuse. However, it does not take into consideration the cost and difficulty of such monitoring and the costs associated with legal action. It does not specify the frequency required for monitoring, creating a vague and uncertain standard for compliance. Its estimates of that burden do not meet the requirements of the Paperwork Reduction Act.

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[4] Some, but by no means all stored value cards and gift cards can only be redeemed by the entity that issues the card. Many can be redeemed by multiple merchants, many are equivalent to cash and may be used at ATM machines, and many can be redeemed at foreign locations as well as domestic locations, making them usable, for example, at a foreign hotel that offers not only a casino but online gambling from the person's hotel room.

- The Proposed Regulation would implement the final regulation within six months of its publication, yet provides no objective basis for its conclusion that the policies, procedures, and internal controls required by the Proposed Regulation would be feasibly undertaken in that period, even if the final regulation provides clarity on key issues that is lacking in the Proposed Regulation.

II. DISCUSSION

A. The Proposed Regulation Does Not Define What Transactions Are Illegal And What Transactions Are Not.

The Proposed Regulation treats the fundamental difference of opinion between the Agencies and the Department of Justice ("DOJ") as to what transactions are illegal, and therefore must be blocked, as if the difference does not exist. The DOJ has long taken the position that all Internet Gambling is illegal under the Wire Act of 1961. The DOJ position is that it is illegal to bet on the Internet on horseracing, dog racing, in intratribal activity and intrastate.[5] However, UIGEA clearly exempts three categories of transaction from the definition of "unlawful Internet Gambling." The definition of "unlawful Internet Gambling" excludes: intrastate transactions (bets made exclusively within a single state); intratribal transactions (bets made exclusively within the Indian lands of a single Indian tribe or between the Indian lands of two or more Indian tribes authorized by Federal law); interstate horseracing transactions as permitted under the Interstate Horseracing Act ("IHA"), and certain types of online wagering activities offered by Fantasy Sports Leagues.[6] This definition is preserved in the Proposed Regulation, but also states that UIGEA did not amend federal or state laws regarding gambling, which as noted, the DOJ continues to interpret to ban all forms of Internet Gambling, including horse-racing, intra-tribal and intra-state Internet Gambling.

This difference of opinion creates a conflicting legal interpretation by the federal government that makes it impossible for a private sector entity to make a reasonable judgment as to what transactions are restricted and which are not. The only "guidance" provided under the Proposed Regulation is a statement that "the Agencies" preliminary view is that issues regarding the scope of gambling-related terms should be resolved by reference to the underlying substantive State and Federal gambling laws and not by a general regulatory definition."[7]

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[5] 72 Fed. Reg. at 56681, n. 1 (noting that the DOJ has consistently taken the position that Internet bets and wagers on horse races violates Federal law and that the Interstate Horseracing Act did not alter than prohibition). Separately, DOJ has advised jurisdictions that would make Internet Gambling lawful that it is illegal even within the confines of their jurisdiction due to its use of a medium, the Internet that crosses jurisdictions for the transmission of information. See letter dated January 2, 2004, from United States Attorney David M. Nissman to Judge Eileen R. Petersen, Chair of the U.S. Virgin Islands Casino Control Commission, in which U.S. Attorney Nissman stated it was the position of DOJ that Internet Gambling was illegal even if it took place intrastate. It is not clear whether DOJ views any type of Fantasy Sports League Internet Gambling to violate federal and/or state laws, although such activities are exempted under UIGEA. The Proposed Regulation does not address the issue, leaving the status of such activities unsettled, too.

[6] 72 Fed. Reg. at 56681.

[7] *Id.* at 56682.

Thus, a designated payment system (and all covered entities to the extent that they were not relying solely on the rules of the designated payment system) would be required to guess as whether horse-racing, dog-racing, intra-tribal transactions, and intra-state transactions that involve online gambling are lawful, and therefore not restricted, or are not lawful, and there are restricted. The Proposed Regulation does not provide an answer to this question, and it is inherently unreasonable to require covered payment systems and institutions to gamble on whether the federal government will ultimately interpret the answer to come up "red" (restricted) or "black" (unrestricted).

A regulation that refuses to advise covered persons of what activities are subject to the regulation raises constitutional, as well as statutory questions. This is the case when a regulation fails to define an offense with sufficient definiteness that ordinary people can understand what conduct is prohibited and encourages arbitrary and discriminatory enforcement.[8] Here, the Proposed Regulation expressly does not take a position as to what types of transactions are restricted and which are not restricted. As a result, it is fatally defective and must be revised to provide such a definition.

Beyond this fundamental deficiency for failure to define what are Restricted Transactions and what are not Restricted Transactions under federal law is the failure of the Proposed Regulation to provide any guidance on what state laws this federal regulation is seeking to enforce.

As drafted, the Proposed Regulation would require each covered payment system to retain counsel to provide an opinion on the coverage of each and every applicable state gambling law to be able to determine whether a particular transaction involved an unlawful Internet bet or wager and was therefore a Restricted Transaction that must be blocked, making compliance overly burdensome and costly to implement. Deciding which transactions were truly restricted transactions would be extremely difficult, as evidenced by the fact that the Agencies and DOJ are unable to provide guidance to covered entities regarding what transactions are restricted and which are not.

The Proposed Regulation does not provide a covered payment system with a mechanism to determine whether its policies and procedures comply with UIGEA. Any judgment they make regarding the coverage of any state law could be challenged as incorrect by federal regulators during the examination process, subjecting them and all covered entities within that designated payment system to liability under UIGEA if found not to be reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions.

For the reasons expressed above with regard to federal law, this approach raises fundamental due process issues under well established Constitutional doctrines applicable to civil as well as to criminal statutes.[9] For a designated payment system and any covered entity to be able to block a restricted transaction because it is illegal under federal or state law, the Agencies must first tell

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[8] See e.g. *Kolender v. Lawson*, 461 U.S. 352, 357, 103 S. Ct. 1855, 75 L. Ed. 2d 903 (1983), with regard to the standard for a criminal statute. See also *Southeastern Fisheries*, 453 So.2d at 1353, with regard to failure sufficiently to define an offense in a regulation.

[9] See e.g. *Grayned v. City of Rockford*, 408 U.S. 104 (1972).

them what those laws prohibit, and therefore, what does constitute a Restricted Transaction and what does not constitute a Restricted Transaction.

In particular, in order to avoid being deficient as overly vague, the regulation needs to state expressly whether the making of payments relating to online gambling on horse-racing is lawful if it meets with the requirements of the Interstate Horseracing Act of 1978; whether the making of payments where the bet or wager is initiated and received or otherwise made exclusively within a single State is lawful when otherwise meeting the requirements set forth in UIGEA if lawful; and similar finding regarding intra-tribal Internet Gambling, and other types of gambling that may be exempt. In addition, the regulation needs to advise which states and tribal areas have been found by the federal government to have in place the required age and location verification requirements and data security standards mandated by UIGEA, thereby providing designated payment systems and covered entities sufficient notice to determine whether a transaction should be deemed to be a Restricted Transaction or not. As discussed below, this could be accomplished by the Agencies providing those subject to regulation under UIGEA with a list of those entities found to be providing lawful Internet Gambling as defined in the Act.

B. The Overblocking Provision Is Overbroad and Will Cause Immediate and Direct Negative Impact To Legitimate U.S. Businesses.

The Proposed Regulation does not meet the legal requirement set forth in UIGEA to prevent overblocking. Under the Proposed Regulation, designated payments systems are provided immunity from liability for blocking transactions that are in fact lawful, if there is a reasonable basis to believe that the transaction may be a restricted transaction.[10] There is no corresponding immunity from liability for failure to block transactions that are ultimately found to have been restricted. Such an immunity would allow designated payment systems and covered entities the ability to reach an independent determination in good faith as to whether a transaction is restricted or not, without being liable for a failure to block one that proves to be restricted. The absence of immunity places these systems and entities in the position of having to overblock, or risk liability for inadvertent processing of transactions ultimately deemed to be restricted.

This approach violates the requirements of UIGEA, which requires the federal regulators to ensure that transactions in connection with any activity excluded from the definition of unlawful Internet Gambling are not blocked or otherwise prevented or prohibited by the prescribed regulations.[11] While the Proposed Regulation recites this requirement, it provides no means to designated payment systems and covered entities to carry out the mandate of this requirement, and provides only the "one-way" safe harbor for overblocking, but none for underblocking. This lack of a standard will certainly lead to the blocking of legitimate transactions, despite the fact that UIGEA expressly requires the Proposed Regulation to ensure that non-restricted transactions are not blocked, with the result that consumers engaged in legal online gambling, as well as the institutions involved in the payment process will face costly uncertainties throughout the payment process in connection with transactions that are lawful. No doubt the horseracing and

[10] *Id.* at 56688.

[11] *Id.* ("[n]othing in this regulation requires or is intended to suggest that designated payment systems or participants therein must or should block or otherwise prevent or prohibit any transaction in connection with any activity that is excluded from the definition of 'unlawful Internet Gambling').

dog racing industries (and their millions of customers) will object to having their transactions suddenly blocked. The near-term economic costs to these lawful industries will be substantial, even apart from the impact of the inevitable litigation required to clarify whether online transactions relating to their industries are lawful and unrestricted, or illegal and Restricted Transactions. There will also be further costs to the federal government due to the need to defend agency action in connection with the issuance and enforcement of the Proposed Regulations.

In the guidance accompanying the Proposed Regulation, the Agencies specified their reasons for not providing a list of companies whose transactions would be deemed to constitute Restricted Transactions. The Proposed Regulation did not address the reverse option, by which the Agencies would provide a list of companies whose transactions would be found to constitute transactions that are *not* restricted, as they fall within the categories of transactions specified in UIGEA as not subject to that definition. Such companies might include, for example, companies providing Internet Gambling services that are lawful under the Interstate Horseracing Act, or which are carrying out Internet Gambling services that are intra-state or intra-tribal and which otherwise meet the mandates of UIGEA. They could also include companies providing Fantasy Sports Internet Gambling in cooperation with sports leagues, and meeting the requirements of UIGEA. Fantasy Sports Internet Gambling, which is reportedly a multi-billion dollar industry,[12] is expressly exempted by UIGEA from coverage, yet may be coded or otherwise treated by participants in the payments system as identical with other forms of Internet Gambling.

It is respectfully requested that the Agencies consider the feasibility of this approach through a system whereby companies engaged solely in those activities expressly specified as not to constitute Restricted Transactions under UIGEA could advise the Agencies that they are engaged in lawful Internet Gambling activities, and be listed as doing so by the Agencies, thereby providing adequate guidance to those seeking to comply with their obligations under the regulation, while providing a mechanism to avoid the overblocking problem.

C. Financial Transaction Providers Are Not Given Sufficient Guidance on Compliance with Proposed Regulation.

Section 5 of the Proposed Regulation requires all non-exempt participants in covered payment systems to establish policies and procedures that are reasonably designed to identify and block restricted transactions. The Proposed Regulation also requires non-exempt financial transaction providers that are participants in a payment system to be in compliance with the Proposed Regulation, but provides that the non-exempt financial transaction provider will be considered in compliance if it relies on and complies with the policies and procedures of the covered payment system in which it is a participant.[13]

The definition of "financial transaction provider" is extremely broad and open-ended, covering essentially any entity participant in a designated payment system.[14] To be in compliance, the

[12] See e.g. "Court Won't Reconsider Decision Favoring Fantasy Sports Leagues," Bloomberg News, November 26, 2007, http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aGSQgvgz.Lvl.

[13] *Id.* at 56697.

[14] *Id* at 56696. The term "financial transaction provider" means "a creditor, credit card issuer, financial institution, operator of a terminal at which an electronic fund transfer may be initiated, money transmitting business, or

financial transaction provider will be required to evaluate the covered payment system's policies and procedures and assess whether they are in compliance with the Proposed Regulation. However, there is no guidance for financial transaction providers as to what level of investigation of the payment system is required, nor is it clear how much information the covered payment systems will be willing to provide, especially given the likely number of financial transaction providers that may be involved. It does not appear that the Agencies have taken into consideration how such an investigation and verification process would work in practice, especially given the general lack of guidance provided to covered payment systems as to what the Agencies will consider reasonably designed policies and procedures.

The Proposed Regulation must be revised to provide guidance to covered entities as to how they are to determine that a designated payments system has established policies and procedures that meet the standard of being reasonably designed to identify and block restricted transactions. One method by which this could be done is for the Agencies to agree to review proposed policies and procedures of each designated payments system and then to issue public notice specifying which designated payments system policies and procedures meet this standard, so that participants in that system may therefore rely on them to gain the benefit of the safe harbor. If the Agencies were to take this approach, the final regulation should also defer requiring any covered entity using any particular designated payments system to adopt policies and procedures to block Restricted Transactions until the regulators have certified such policies and procedures for that type of payment.

D. There is Insufficient Guidance on What Constitutes "Reasonably Designed Policies and Procedures" and Suggested Examples Are Difficult and Costly to Implement

Lack of flexibility.

Section 6 of the Proposed Regulation identifies, by designated payment system, what types of policies and procedures the Agencies will consider to be "reasonably designed to identify and block restricted transactions."[15] The Agencies also expressly state that the list of examples is non-exclusive and that covered payment systems may incorporate different policies and procedures to fit the particular business model.[16] However, under the Proposed Regulation, unless a covered payment system incorporates the identified policies and procedures, it will not be within the safe harbor and could therefore face civil liability for failing to have reasonable policies and procedures. Thus, the approach taken by the Agencies, which might seem to provide for flexibility, essentially mandates a one-size-fits-all approach in which the non-mandatory "examples" will be in practice be mandatory requirements due to the lack of any alternatives qualifying for the safe harbor.

When does a payment system "become aware"?

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international, national, regional or local payment network utilized to effect a credit transaction, electronic fund transfer, stored value product transaction, or money transmitting service, or a participant in such network, or other participant in a designated payment system."

[15] 72 Fed. Reg. 56698.

[16] *Id.*

In the Proposed Regulation, the Agencies require the policies and procedures to implement UIGEA to include procedures the covered payment system will follow when it "becomes aware" that a customer has received restricted transactions.[17] The phrase "becomes aware" if not further defined in the Proposed Regulation. The phrase does not specify an actual level of knowledge; it is unclear if the covered payment system must have "actual knowledge," a mere "reasonable basis to believe," or some other standard. As currently drafted, a covered payment system could be considered to have "become aware" if it receives any sort of notification that a customer received a restricted transaction.

Additionally, the Proposed Regulation does not specify which personnel at the covered payment system would be responsible for having the knowledge that restricted transactions were occurring – would the covered payment system be viewed as "aware" of such transactions if a single individual learns of a restricted transaction, even if that individual is not involved in the underlying policies and procedures required by the Proposed Regulation? Clarifying the meaning of the phrase is extremely important. As currently drafted the Proposed Regulation could be interpreted very broadly, potentially subjecting well-known, well-respected, and highly regulated entities to civil liability and reputational injury for inadvertent failures to take action based on the knowledge of a single, low-level employee.

For this reason, it is respectfully suggested that the Proposed Regulation be revised to provided that the standard for knowledge be specified to require "actual knowledge" and that this "actual knowledge" have been communicated to persons at the covered entity responsible for compliance with the regulations.

What volume or size of restricted transactions triggers penalties on merchants?

Even if the Proposed Regulation included an identifiable standard for the level of knowledge required for the covered payment system to "become aware," the Proposed Regulation does not give sufficient guidance on what volume of restricted transactions would trigger the remedies required by the Proposed Regulations. As drafted, the Agencies proposed that if the covered payment system "becomes aware that the customer has received restricted *transactions*"[18] (emphasis added) it must have policies and procedures in place to address when fines should be imposed against the customer, when the customer should not be allowed access to the system, or when the account should be closed. Thus, as drafted, the Proposed Regulations would require some action to take place against a customer if the covered payment system became aware of *two or more restricted transactions*. Since the value of the restricted transaction could be extremely small, it is possible that the Proposed Regulation would require the covered payment system to close the account of a long-standing, high-volume commercial customer if the covered payment system becomes aware of the customer receiving even two restricted transactions, regardless of how small those transactions might be. Such a requirement would undoubtedly damage the smooth flow of the payment system.

There are several key questions that must be addressed for there to be sufficient guidance on this requirement:

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[17] *See e.g.*, 72 Fed. Reg. 56699. The requirement applies to all covered payment systems.
[18] 72 Fed. Reg. 56699.

- What transaction size and transaction volume must be reached before the Agencies believe a commercial entity should impose fines, restrict access, or close the account of a commercial customer?

- Is it the position of the Agencies that once an account is closed, the payment system may not reopen the account for that same customer?

- Given the lack of guidance as to what level of knowledge will be required on the part of the covered payment system, to what extent do the Agencies believe the covered payment system should afford the customer the opportunity to provide evidence that the transactions were not restricted transactions?

- What is the Agencies' position where the covered payment system believes a transaction to be restricted but the customer believes it is not a restricted transaction (such as a transaction pursuant to the Interstate Horseracing Act or an intrastate or intratribal transaction)?

It is respectfully suggested that the Agencies must answer these questions, revise the Proposed Regulation in light of the answers, and provide a further opportunity to affected persons to comment on such answers prior to the issuance of any final regulation.

Screening merchants.

The Proposed Regulation requires covered payment systems to screen potential merchant customers to ascertain the nature of their business and to ensure that they are not involved in accepting restricted transactions.[19] While seemingly straightforward, this requirement is extremely vague as to what level of screening will be required and what level of knowledge of underlying businesses the covered payment system must have.

Several critical questions must be answered to ensure that sufficient guidance is available to covered payment systems subject to this vague requirement.

For example:

- Will the covered payment systems have to perform lengthy, comprehensive background investigations for each potential merchant customer?

- What documentation of that investigation will be required?

- Is the covered payment system obligated to perform periodic reviews of the merchant customer to determine if the merchant customer has become involved in Internet Gambling transactions? If so, how frequently must such reviews be undertaken?

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[19] *See e.g.* 72 Fed. Reg. 56698.

- Do the Agencies contemplate a flexible, risk-based approach to the investigation, such that smaller covered payment systems or those that may have lower-risk businesses are not required to do the same investigation as larger, potentially more risky entities?

- Is there a difference in the type of investigation that should occur with respect to a merchant customer that is a well-known, national retailer as opposed to a less well-known company that may not have a lengthy business history?

- To what extent do the foreign activities of the merchant customer affect the investigation – if the merchant customer is involved in Internet Gambling transactions that are legal in a foreign jurisdiction, would that factor cause concern among the Agencies?

The answers to these questions will have a material impact on the design by each designated payment system of policies and procedures deemed sufficient to comply with the final regulation. It is therefore critical that the answers be provided in a subsequent Proposed Regulation for comment by all affected parties. Because the Information Collection Request relating to the Proposed Regulation is incomplete, the government has yet to take appropriate steps to allow merchants, software firms, and other services providers to covered entities to: 1) become aware that they would be impacted by the proposed rule; and 2) the ways in which they would be impacted. Thus, a further comment period is required to allow these affected firms to effectively participate in the rulemaking.

Rewriting merchant customer agreements.

The Proposed Regulations require covered payment systems to include in merchant customer agreements language that the merchant will not receive restricted transactions.[20] Here again, the Agencies are requiring the individual covered payment systems to determine what is and what is not a restricted transaction; with numerous potential interpretations among the many payment systems. In addition, the Agencies do not indicate whether this requirement applies to existing contracts or only to new customer relationships. This lack of clarity in the Proposed Regulation raises further questions that need to be answered prior to the issuance of a final regulation.

They include:

- Will participants in designated payment systems be forced to reopen existing contracts, or require amendment to existing contracts, to comply with the Proposed Regulations?

- How would the Ageneies propose to address situations where the same merchant is faced with contracts from participants in multiple covered payment systems, which may have different interpretations of what constitutes a restricted transaction?

The Proposed Regulation should be revised to specify whether covered entities must revise existing contracts with services providers and with correspondent banking, merchant, and customer relationships to counter the use of each of those relationships for carrying out what

[20] *Id.*

might be Restricted Transactions under the regulation. If the final regulation requires revisions to such contracts, it needs to provide for an adequate period for such renegotiations, which in the case of some covered entities could involve hundreds of separate contracts (or more) with banks, merchants, other customers, and services providers. Given the sheer number of contracts that could be affected, and the reality that many of the counterparties to such contracts may be located in other jurisdictions where Internet Gambling activities are lawful, the minimum period allowed for imposing such additional contractual obligations should be no less than one year following the effective date of any final regulation.

Expanded Government Regulation of Stored Value Cards.

The Proposed Regulation defines "card system" as "...a system for clearing and settling transactions in which credit cards, debit cards, pre-paid cards, or stored value products, issued or authorized by the operator of the system, are used to purchase goods or services or to obtain a cash advance."[21] This definition expressly covers stored value products, many of which are issued with low-dollar limits, typically of less than $500 and often of less than $100. The size of the domestic stored value card industry has been estimated in a 2005 Federal Reserve study to exceed 36 million cards, which also generally does not have mechanisms in place that could be tailored to enable identification of Restricted Transactions. Indeed, the 2005 Federal Reserve study expressly noted that uncertain legal and regulatory conditions may stifle innovation in the industry, as compliance with an increasing number of laws and regulations, particularly at the state level, may make products too expensive to offer. [22] Such cards do not ordinarily today have any controls regarding the person purchasing the card, or the purposes for which the card is used. For this reason, issuers, marketers, sellers, and redeemers most often have no policies or procedures in place to track (or limit) the type of use of the card by the purchaser, as would be required for compliance with the Regulation. Thus, the Proposed Regulation requires an entirely new set of compliance obligations for all those involved with stored value cards, despite the fact that existing federal anti-money laundering laws ("AML") have expressly, to date, exempted them from coverage under existing regulations governing money services businesses.

The reasoning behind the complete exclusion in the final Bank Secrecy Act ("BSA") Money Services Business registration rule of issuers, sellers, and redeemers of stored value card products logically would seem to apply to excluding participants in stored value systems from this Proposed Regulation.

As explained by the Treasury in its final rule:

> The final rule continues to treat "stored value" as a financial instrument whose issuers and sellers are financial institutions for purposes of the Bank Secrecy Act. However, the final rule revises the Notice to exempt stored value issuers and sellers from any money services business registration obligation. Under the circumstances, the only immediate consequence of the rule will be to make clear that currency transactions in excess of $10,000 by stored value issuers and sellers require reporting under the Bank Secrecy Act

[21] 72 Fed. Reg. 56696.

[22] See Stored Value Cards: Challenges and Opportunities for Reaching Emerging Markets, A Working Paper for the Federal Reserve Board 2005 Research Conference, http://www.newyorkfed.org/regional/svc_em.pdf.

> (rather than under section 6050I of the Internal Revenue Code) and that businesses that participate as financial intermediaries in transactions in which stored value is transferred electronically may, if otherwise covered, be subject to the rules requiring the maintenance of records for funds transfers of $3,000 or more.
>
> This limited treatment of stored value—which frees the industry from registration requirements to which issuers and sellers of money orders and traveler's checks will be subject— eliminates the "chilling effect" on the technology industry to which commenters objected. The limited step that is being taken should create certainty as to the outlines of the Bank Secrecy Act's application to electronic funds equivalents, while allowing further development prior to any rulemaking that deals with more specific issues such as, for example, exemptions for "closed system" or small denomination stored value devices or the terms for possible tailored application of the registration or other Bank Secrecy Act requirements to aspects of these emerging payment products.[23]

The BSA regulation providing the exemption to stored value cards and their issuers, sellers and redeemers from coverage under the BSA is now more than eight years old. It has never been revised, and thus entities in these businesses have not been expressly mandated to have policies and procedures in place today covering those products for anti-money laundering purposes unless they are otherwise covered under the BSA. Notably, the BSA regulation expressly recognizes that if regulation of stored value products is ever to come into effect, it may need to provide exceptions for small denomination stored value products to avoid the risk of chilling the entire industry and making otherwise lawful and important consumer financial products unfeasible.

Given this history, it is respectfully suggested that the Proposed Regulation be revised to exempt stored value cards, or at the very least, stored value cards below a threshold amount, pending an overall revision of the status of these cards by the Agencies. The Agencies should not regulate these products through the "back door" of covering them under UIGEA when they have declined to regulate them through previous regulatory processes relating to money laundering, an area of much greater breadth and concern, domestically and internationally, than the far narrow topic of Internet Gambling.

It is respectfully suggested that the Agencies engaged in a further request for comment on the specific question of whether thresholds should be imposed on any coverage of stored value cards to prevent Restricted Transactions, and if so, what an appropriate threshold might be.

New Federal Regulation of Gift Cards.

Remarkably, the Proposed Regulation's definition of cards implicitly includes gift cards, a product that was estimated to amount to a $35 billion domestic U.S. market as of 2005 and to a $76 billion domestic U.S. market in 2006, and which previously have not been regulated by the

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[23] Financial Crimes Enforcement Network, 31 CFR Part 103, RIN 1506–AA09, Amendment to the Bank Secrecy Act Regulations—Definitions Relating to and Registration of, Money Services Businesses, **Federal Register/Vol.** 64, No. 161 / Friday, August 20, 1999 http://www.fincen.gov/msbreg1.pdf.

Federal government.[24] Essentially, none of those involved in the issuance or sale of such cards today have mechanisms in place to determine the identity of the purchasers of the cards, or entities involved in the redemption of the cards for goods or services. The Proposed Regulation would seem to require that issuers, sellers, and redeemers of gift cards also have anti-Internet Gambling controls applicable to the cards.

Today, gift cards are issued, sold, and redeemed by a wide variety of categories of businesses, from regulated financial institutions, to hotel chains, malls, merchants, telecommunications companies, multinational media conglomerates, among others, and often on a global basis where they can be used throughout the world.

Currently, a gift card in any denomination could be sold, in the United States or in other country, such as the United Kingdom where Internet Gambling is lawful, by a retailer for redemption by that retailer on a global basis, such as by a hotel chain or entertainment company. That chain or company in turn might permit Internet Gambling at any of its facilities in a jurisdiction where such activity is lawful. Under the regulation, the entity issuing such a card, or a merchant acquirer, would need to have policies and procedures in place to restrict its use by a U.S. person engaged in Internet Gambling, and such controls might also *indirectly* apply to the seller of the card, those processing the card, and those redeeming the card, depending on their relationship to the covered entities and to any business involved in Internet Gambling.[25] It appears from the Proposed Regulation that the Agencies consciously intended to cover gift cards, despite the fact that the Federal government has previously left the regulation of gift cards to the individual states.

The burden of a new regulation covering all entities acting as a card system operator, a merchant acquirer, or a card issuer is likely to be substantial. To begin with, many of the issuers (at least) are not financial institutions for BSA purposes. Further, most gift cards are today sold without controls or limitations on the purchaser of the card, that is, anonymously, without requirements for customer identification. Many are sold as "open cards," without controls or limits on the intended use of the card, in terms of specific limits on the types of goods or services that may be purchased. Many gift cards are also sold on a basis that allows them to be used globally, inside the U.S. and outside the U.S. These features make the imposition of controls to block Restricted Transactions involving gift cards virtually unenforceable, in the absence of specific physical, technological restrictions that prevent consumers from purchasing the cards and using them at online merchants, or at overseas locations. Such restrictions would have a dramatic impact on the utility of the gift cards for many entirely lawful purposes.

It is respectfully suggested that the Agencies exempt gift cards entirely from the regulation, relying on the authority granted them in UIGEA to do so when such regulations are not feasible.

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[24] http://www.marketresearch.com/product/display.asp?productid=1125176&g=1.
Media accounts suggest the current figure may be closer to $90 billion as of 2007. See e.g. "Card Tricks: Gift Cards Are Big Business for Retailers," http://chiefmarketer.com/cm_plus/gift_cards_retailers/.

[25] It is not clear from the Proposed Regulation whether such cards would also have to be restricted in their use outside the U.S., given their issuance to a U.S. person in the U.S. Clarity on this point might be facilitated through the provision of a definition in the regulation as to what types of transactions are restricted due to being illegal under federal or state laws and what are not.

If the Agencies do not provide a comprehensive exemption for gift cards, they should provide an explanation as to why gift cards should be subject to regulation under UIGEA but not other Federal laws, and should specify why the Agencies have not decided to use the authority granted them in UIGEA to exempt gift cards from coverage.

Alternatively, the Agencies should at least grant an exemption for gift cards below a threshold amount, pending an overall revision of the status of these cards by the Agencies. As with stored value products, the Agencies should not regulate gift cards through the "back door" of covering them under UIGEA when they have declined to regulate them through other previous regulatory processes. Again it is respectfully suggested that the Agencies engage in a further request for comment on the specific question of whether thresholds should be imposed on any coverage of gift cards to prevent Restricted Transactions, and if so, what an appropriate threshold might be.

Potential Damage to Correspondent Banking Relationships.

Under the Proposed Regulation, covered ACH system participants[26] and check collection systems[27] are required to have policies and procedures in place to ensure that foreign senders or foreign banks do not send restricted transactions to the U.S. and to take action against the foreign bank or sender if they do send restricted transactions to the U.S.

These requirements pose significant problems for domestic financial institutions and payment systems and constitute a mechanism that would export the U.S. prohibition against Internet Gambling to foreign jurisdictions where such transactions are lawful. Internet Gambling is a legal, regulated activity in numerous foreign jurisdictions, including the U.K., and reputable, global, financial institutions process those transactions with regularity. The Proposed Regulation expressly requires U.S. institutions to require foreign banks to agree to identify and block transactions that are unlawful in the U.S. but that may be lawful in the jurisdiction in which the foreign bank exists. This single requirement poses several major problems:

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[26] 72 Fed. Reg. 56698. ACH operators must have policies and procedures in place "for conducting due diligence in establishing or maintaining the relationship with the foreign sender designed to ensure that the foreign sender will not send instructions to originate ACH debit transactions representing restricted transactions to the receiving gateway operator or third-party sender..." In addition, the ACH system must have "procedures to be followed with respect to a foreign sender that is found to have sent instructions to originate ACH debit transactions to the receiving gateway operator or third-party sender ... which may address (A) when the ACH services to the foreign sender should be denied; and (B) the circumstances under which the cross-border arrangements with the foreign sender should be terminated."

[27] 72 Fed. Reg. 56699. Specifically, check collection systems must have policies and procedures to "(i) [a]ddress methods for conducting due diligence in establishing or maintaining the correspondent relationship with the foreign bank designed to ensure that the foreign bank will not send checks representing restricted transactions to the depositary bank for collection, such as including as a term in its agreement with the foreign bank requiring the foreign bank to have reasonably designed policies and procedures in place to ensure that the correspondent relationship will not be used to process restricted transactions; and (ii) [i]nclude procedures to be followed with respect to a foreign bank that is found to have sent checks to the depositary bank that are restricted transactions, which may address – (A) when the check collection services for the foreign bank should be denied; and (B) the circumstances under which the correspondent account should be closed."

- If the foreign bank refuses to include such provisions in its agreement with the U.S. institution, will the Agencies find the U.S. institution to not have reasonable policies and procedures? Will the U.S. institution thus fall outside the safe harbor?

- What if the foreign bank refuses to comply with the U.S. law? Do the Agencies require U.S. institutions to terminate their correspondent banking and other agreements with some of the largest foreign financial institutions in the world?

- If the foreign bank did, for some reason, comply, would they be subject to any liability in their home country for blocking transactions that are legal and legitimate?

Answers to these questions are essential in determining whether a designated payments system can design policies and procedures that are "reasonable" under UIGEA and which also do not create significant risks to the operations of the payments system.

It is vitally important to the designated payments system and covered entities to be provided express guidance as to whether it is necessary to close correspondent relationships with foreign banks that do not agree to halt Restricted Transactions to the U.S. We note that there could be a substantial impact on the efficiency of the payment system if financial institutions in many countries refused to agree not to send Restricted Transactions to the U.S. and as a result were required to terminate correspondent relationships with U.S. banks. Historically, the U.S. Department of the Treasury has been concerned about the implications for the transparency and integrity of the payments system in situations in which foreign financial institutions enter the U.S. payments system indirectly, rather than directly, in order to circumvent U.S. regulatory requirements. There could be substantial negative implications for the U.S. payments system overall were numerous foreign financial institutions to cease to have correspondent banking relationships with U.S. financial institutions. These implications could include substantial inefficiencies in the payment system; a higher cost of doing business in the global marketplace for U.S. financial institutions; a loss of transparency in the U.S. payments system in handling cross-border transactions; and a potential increase in money laundering from other countries due to transactions taking place indirectly as a result of the suspension of correspondent banking relationships that today take place directly.

The Agencies need to determine the extent to which these concerns could constitute significant risks to the payments system, and then provide guidance to designated payments systems and covered entities regarding their obligations concerning foreign relationships that have been found to handle Restricted Transactions in light of the possible impact on the payments system. In light of the importance of the issues highlighted, a further period for comment following the publication of any findings by the Agencies should be provided.

Separately, the Agencies do not specify in the Proposed Regulation how they expect to be able to enforce the Proposed Regulation against a foreign institution in the event the foreign institution decides not to comply with the U.S. law. In light of the inter-connectedness of the international payments system and the goals of UIGEA, the regulation needs to address the issue of circumvention, especially as it relates to such institutions that are accessible from the U.S. For example, the Agencies could require all financial institutions offering accounts online to U.S.

persons, wherever located, to impose restrictions on the use of the foreign accounts for Internet Gambling. Indeed, the failure to do so leaves a major mechanism available for circumvention. Yet were such an approach to be included in a regulation, it is not clear how the Agencies would enforce the regulation. The issue of enforcing the requirements of UIGEA regarding foreign institutions doing business with U.S. persons in the U.S. needs to be addressed in a final regulation.

Ongoing Monitoring for Misuse of Trademark.

The Proposed Regulation requires card systems and money transmitters to incorporate ongoing monitoring of websites to detect unauthorized use of the card system or money transmitter system, including its trademark, in order for the policies to fit within the safe harbor as "reasonably designed to prevent or prohibit restricted transactions."[28] The Agencies expressed a concern that Internet Gambling operators may use an agent to receive restricted transactions on behalf of the Internet Gambling operator, thus avoiding the due diligence efforts of the covered payment system.[29] Such arrangements may involve the unauthorized use of the payment system's trademark as an advertisement on the agent's or Internet Gambling operator's web site.

The Agencies note that some money transmitters subscribe to a service that searches for authorized use of the money transmitters' trademark by other websites.[30] Although there is no additional support offered for this assertion, the Agencies nevertheless rely on it as evidence that money transmitters and credit card systems can and should be involved in ongoing monitoring for such unauthorized use of their trademarks. There is no discussion regarding the cost of such a service, and it is not clear what level of monitoring will be required. This vagueness in the Proposed Regulation requires the designated payments system and covered entities to guess as to the extent of the obligation. Accordingly, the Agencies need to answer the most obvious question about this element of the Proposed Regulation:

- Would the Agencies expect the covered entity to check every mention of it on a website to determine if involves the unauthorized use of the trademark? If so, have the Agencies undertaken a determination regarding the costs of such monitoring to affected persons?

By way of example, a search using the search engine Google for the terms "Western Union" and "Internet Gambling" results in 69,000 hits, a search for "Western Union" and "trademark" yields 194,000 hits, and a search for "Western Union" yields 716,000 hits. Investigating, or even quickly scanning, each hit to determine if there is unauthorized use of the trademark would be, at best, extremely difficult. Moreover, a company such as Western Union may find that it may be lawfully used for Internet Gambling transactions in many countries. Thus, the presence of its trademark on a website would not indicate illegal use. This raises a further question:

- Would the Agencies expect the covered entity to check every use of its service on every website located in all jurisdictions to determine if involves an unauthorized use as applied

[28] 72 Fed. Reg. 56698 (card systems), 72 Fed. Reg. 56699 (money transmitters).
[29] 72 Fed Reg. 56689
[30] *Id.*

to the United States? If so, have the Agencies undertaken a determination regarding the costs of such monitoring to affected persons?

The above example suggests that monitoring could be extremely burdensome for covered entities. The problem is exacerbated because the nature of the Internet is such that any website operator found to be using the trademark in an unauthorized manner could easily move the website and set up at another web address, avoiding any legal action that the covered payment system might initiate.[31]

The Proposed Regulation provides no guidance as to what level of monitoring is required, yet any credit card system or money transmitter that does not undertake ongoing monitoring risks falling outside the Proposed Regulation's safe harbor. It is unlikely that any credit card system or money transmitter will not want to avail itself of the safe harbor, therefore they will have to implement ongoing monitoring of websites or risk facing civil liability for failure to have reasonable policies and procedures.

Additionally, it is not clear what steps the Agencies expect a credit card system or money transmitter to take in the event such unauthorized use is discovered.

E. The "Prohibition" on Internet Gambling Can Be Easily Circumvented Even with the Proposed Regulation

The Proposed Regulation seeks to shut down unlawful Internet Gambling by using the payment system as the choke point in the transfer of funds involved in an Internet wager. However, despite the *regulatory* effort, the Proposed Regulation would not be effective in preventing unlawful Internet Gambling. Even if the Proposed Regulation were implemented as drafted, it would still be possible for a U.S. resident to gamble online, frustrating the fundamental purposes of UIGEA, which the Proposed Regulation seeks to enforce.

Under UIGEA, a U.S. resident could still open a foreign bank account in a jurisdiction where Internet Gambling is legal, and use that account as any other similar type of account – making purchases, online banking, etc. The account could also be used for Internet Gambling, which would not be prohibited by federal U.S. law because the law of the foreign jurisdiction would apply. At such time as the individual wanted to repatriate the funds, the individual could simply transfer all or part of the money to the United States. Provided that the U.S. resident reported the bank account to appropriate U.S. authorities, there is no federal prohibition on an individual gambler having the account or using it for lawful purposes under the law of the jurisdiction where the account is located. Thus, whether the U.S. resident wanted to use the funds in the account to gamble online, pay bills, or make purchases, he or she would be free to do so subject to applicable state laws.

[31] The Agencies expressly cite the ability of foreign operators to easily take down and restart a website as justification for their inability to provide a list of Internet Gambling sites to covered payment systems. However, the Proposed Regulation does not address the implications of this finding for the ability of covered entities successfully to undertake the monitoring set forth in the Proposed Regulation.

Similarly, it appears that a U.S. resident could use a credit card, stored-value card, pre-paid card or debit card that is issued by a foreign financial institution and usable for a variety of purposes to conduct Internet Gambling activity without violating federal U.S. law.

The Proposed Regulation does not meaningfully address this circumvention problem, with that the result that it sets forth a regulatory regime that would result in discriminatory treatment of U.S. financial institutions and preferential treatment of foreign financial institutions handling the identical transactions for a U.S. person. This is a significant deficiency in the regulation, because the regulation makes no effort to address transactions that take place entirely outside of the U.S. payments system but which are initiated and controlled by U.S. persons.

The reality of ready circumvention undermines the utility of the entire Proposed Regulation, as it imposes enormous costs on designated payments systems and covered entities without achieving commensurate benefits in addressing the policy goals established by UIGEA. For this reason, revisions to the Proposed Regulation should address the circumvention issue. There may be numerous additional regulatory measures that could be taken to reduce the circumvention problem. For example, the regulation could require designated payment systems and all participants in such systems to file suspicious activity reports with Treasury for each incident in which they found they were handling a transaction that might possibly constitute a Restricted Transaction, backed by fines or criminal sanctions for willful non-compliance. The resulting data-base would provide a mechanism for federal law enforcement officials to bring cases not against operators, but against payments providers, and against individual gamblers in violation of state laws limiting gambling. Criminal cases could be brought not only against those involved in sports betting, an area traditionally understood to be covered by the Wire Act, but against those involved in horse-racing, dog-racing, poker, bingo, state-authorized online gambling, online betting in tribal areas, any and all of which appear to be subject to UIGEA based on existing DOJ testimony and prosecutions. Such criminal cases would of course have to be brought on a non-discriminatory basis, covering all types of gambling and all types of persons involved in allegedly improper activity, including persons actually based within the U.S., in a manner that does not involve unequal enforcement of the law or abuse of discretion. The resulting litigation, civil and criminal, from regulations that effectively discouraged circumvention, would surely rapidly clarify the state of the law for all parties, and do much to enforce the goals articulated in UIGEA.

F. <u>The Proposed Regulation Exacerbates the Ongoing WTO Dispute</u>

Though not directly within the immediate scope of the text of UIGEA, it is worth noting that the Proposed Regulation, if finalized, will exacerbate the existing trade dispute with the WTO. The trade dispute centers on the protectionist treatment by the U.S. of its domestic Internet Gambling businesses. Specifically, the U.S. was challenged by the nation of Antigua, which has a thriving, *legal*, Internet Gambling industry, because the U.S. does not permit foreign entities from engaging in Internet Gambling in the U.S. Antigua noted that the U.S. does not prohibit all Internet Gambling, but rather only allows domestic operators involved in limited activities such as horseracing and dog racing. The WTO found that the U.S. was in violation of its commitment to the WTO on Internet Gambling and thus was obliged to either change its policies to allow

foreign competition or shut down the domestic industry.[32] The U.S. instead chose to withdraw its commitment, which, aside from the dangerous precedent being set, permits injured nations to request compensation from the U.S.

Because UIGEA and the Proposed Regulations expressly state that they do not impact the current legality or illegality of Internet Gambling, they fail to address the core issue in the WTO ruling against the United States. Rather, the passage of UIGEA and the subsequent release of the Proposed Regulation potentially exacerbate the scope of damages faced by the U.S. in compensation for its discrimination against foreign operators due to its Internet Gambling regime and decision to withdraw its trade commitment relating to gaming.

UIGEA grants the Agencies the authority both to exempt certain restricted transactions or designated payment systems from any requirement imposed under such regulations, if the Secretary and the Board jointly find that it is not reasonably practical to identify and block, or otherwise prevent or prohibit the acceptance of, such transactions; and to ensure that transactions in connection with any activity excluded from the definition of unlawful Internet Gambling are not blocked or otherwise prevented or prohibited by the prescribed regulations. Regrettably, the Proposed Regulation does not properly use this authority to minimize the costs to the United States arising from the WTO ruling.

The costs to the U.S. arising from the WTO ruling could be reduced by the Agencies defining what are and what do not constitute Restricted Transactions and ensuring that any definition of Restricted Transactions covers domestic operators identically to the coverage of foreign operators.

G. The Proposed Regulation Does Not Meet the Requirements of the Paperwork Reduction Act or the Regulatory Flexibility Act

The Proposed Regulation has not provided "a specific, objectively supported estimate of burden" as required by 44 U.S.C. §3506(c)(l)(A)(iv). By failing to identify all of the parties subject to its mandate, it has provided incorrect and unsupported statements regarding the burden on small businesses. It also has not provided burden estimates for many of the information collection tasks set forth in the Proposed Regulation. In fact, the range of covered entities is enormous, involving not only designated payments systems but many types of participants in those systems, including card operators, money transmitters, issuers of stored value cards, issues of gift cards, redeemers of stored value cards, redeemers of gift cards, merchant acquirers, and depository institutions, among others.

The Paperwork Reduction Act requires the Agencies to determine the burden for each of these types of businesses to develop and implement policies and procedures (including software costs, training, legal costs, management time, verification/quality checking, etc.) to identify and block restricted gambling transactions. Yet the regulation does not accurately identify the universe of certain categories of those covered, providing no specific numbers for the numbers of entities

[32] "United States – Measures Affecting The Cross-Border Supply Of Gambling And Betting Services Recourse To Article 21.5 Of The DSU by Antigua and Barbuda Report Of The Panel, WTO," Available at: Http://Www.Antiguawto.Com/Wto/72article215paneldecision.Pdf.

involved in stored value cards and gift cards that would be subject to the record-keeping requirements associated with cards.

The Regulatory Flexibility analysis states that the Agencies "do not have sufficient information to quantify reliably the effects the Act and the proposed rule would have on small entities."[33] This remarkable assertion is per se evidence that the Agencies have not been able to gather the data necessary to meet their obligations to determine the impact of the proposed rule on small entities as defined in the Regulatory Flexibility Act.

The Agencies need to identify how many small entities would be affected by the Proposed Regulation in connection with their involvement in cards, and on the basis of a full understanding of the implications of the Proposed Regulation (discussed above), revise its estimate of the burden to provide one that meets the statutory requirements of both the Paperwork Reduction Act and the Regulatory Flexibility Act.

H. Regulatory Enforcement

The Proposed Regulation would place enforcement the exclusive regulatory enforcement of (1) the Federal functional regulators, with respect to the designated payment systems and participants therein that are subject to the respective jurisdiction of such regulators under section 505(a) of the Gramm-Leach-Bliley Act and section 5g of the Commodity Exchange Act; and (2) the Federal Trade Commission ("FTC"), with respect to designated payment systems and financial transaction providers not otherwise subject to the jurisdiction of any Federal functional regulators.

We note that for MSBs, this outcome could subject them to the jurisdiction of two different agencies, the FTC for enforcement of UIGEA, and the Internal Revenue Service ("IRS") for enforcement of their anti-money laundering obligations under the BSA. As "Restricted Transactions" are by definition illicit transactions, this would appear to place each federally-registered MSB in the position of having to adopt policies and procedures developed by two different agencies, each of which has the authority to engage in enforcement activity in connection with any alleged violation. Alternatively, the Agencies could take the position that the authority granted the FTC regarding money transmitters is *exclusive*, in which case the IRS would not have authority to examine for compliance with the UIGEA regulation in the course of its examination of a MSB for BSA compliance. Alternatively, the Agencies could find that MSBs are already subject to the authority of the IRS which acts as their existing "functional regulator" within the meaning of this section, and that therefore, the IRS, rather than the FTC, will be the sole regulator over money transmitters for UIGEA purposes.

Clarification of the regulatory oversight of MSBs is required. It is respectfully suggested that MSBs be subject to the authority of only one regulator, and that this be undertaken through the existing examination process mandated under the BSA rather than through a second, separate process involving the FTC.

III. CONCLUSION

[33] Prohibition on Funding of Unlawful Internet Gambling, 72 Fed. Reg. 56690 at 56693.

The Proposed Regulation suffers from numerous deficiencies, which require substantial changes in order for any final regulation not to violate the requirements of UIGEA and other relevant federal laws, including but not limited to the Paperwork Reduction Act and the Regulatory Flexibility Act. These deficiencies are fundamental, and non-trivial, as they make the Proposed Regulation sufficiently overbroad and vague as not to provide sufficient guidance to those affected regarding what actions are lawful and what actions would violate the regulation.

In particular, the Proposed Regulation chooses not to define what types of Internet Gambling transactions are Restricted Transactions and what types of Internet Gambling transactions are lawful. It thus threatens numerous lawful U.S. businesses that have long been engaged in providing Internet Gambling services involving horse-racing, dog-racing, and Fantasy Sports Leagues and which have not been otherwise subject to enforcement activity. It would newly regulate previously undesignated payments mechanisms, such as stored value cards and gift cards, not currently subject to federal regulation; impose unprecedented burdens on participants in the U.S. payments system to monitor the use of their trademarks on a world-wide basis for possible improper use; impose unprecedented due diligence requirements on U.S. financial institutions to monitor, verify, and audit the policies and procedures of their foreign counterparts; and potentially increase the amount of damages the United States could be forced to pay to other countries in connection with the adverse WTO ruling on Internet Gambling. It also threatens significant injury to the payments system due it at minimum complicating and potentially threatening essential relationships of U.S. financial institutions with foreign counterparts.

UC Group believes that the Proposed Regulation, in conjunction with UIGEA, is not only an impractical and unworkable approach to the subject of Internet gambling, but also an unjustified burden on the financial sector institutions and hence the incorrect course of action to pursue. The preferred course of action is to introduce a comprehensive regulatory regime such as that recommended under the Internet Gambling Regulation and Enforcement Act (H.R. 2046).

December 12, 2007

The Honorable Jennifer Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Valerie Abend
Deputy Assistant Secretary for Critical Infrastructure Protection and Compliance Policy
Department of Treasury
Office of Critical Infrastructure Protection and Compliance Policy
Room 1327
Main Treasury Building
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Re: Prohibition on Funding of Unlawful Internet Gambling Act of 2006
Federal Reserve: Docket Number R-1298
Treas-DO: Docket Number Treas-DO-2007-0015

Dear Ms. Johnson:

The Office of Advocacy of the U.S. Small Business Administration (Advocacy) submits this comment to the proposed rulemaking on the Prohibition on Funding of Unlawful Internet Gambling. The Office of Advocacy believes that Department of Treasury and the Federal Reserve System (hereinafter "the agencies") have not analyzed properly the full economic impact of the proposal on small entities as required by the Regulatory Flexibility Act (RFA). Advocacy recommends that the agencies prepare a revised initial regulatory flexibility analysis (IRFA) to address the concerns presented below.

Advocacy Background

Congress established the Office of Advocacy under Pub. L. 94-305 to represent the views of small business before Federal agencies and Congress. Advocacy is an independent office within the Small Business Administration (SBA), so the views expressed by Advocacy do not necessarily reflect the views of the SBA or of the Administration.

Section 612 of the RFA requires Advocacy to monitor agency compliance with the Act, as amended by the Small Business Regulatory Enforcement Fairness Act.[1]

On August 13, 2002, President George W. Bush enhanced Advocacy's RFA mandate when he signed Executive Order 13272, which directs Federal agencies to implement policies protecting small entities when writing new rules and regulations. Executive Order 13272 also requires agencies to give every appropriate consideration to any comments provided by Advocacy. Under the Executive Order, the agency must include, in any explanation or discussion accompanying the final rule's publication in the Federal Register, the agency's response to any written comments submitted by Advocacy on the proposed rule, unless the agency certifies that the public interest is not served by doing so.

The Proposed Rule

On October 4, 2007, the agencies published a proposed rule entitled *Prohibition on Funding of Unlawful Internet Gambling* to implement applicable provisions of the Unlawful Internet Gambling Enforcement Act of 2006 (the "Act").[2] In accordance with the requirements of the Act, the proposed rule designates certain payment systems that could be used in connection with unlawful Internet gambling transactions restricted by the Act. The proposed rule requires participants in designated payment systems to establish policies and procedures reasonably designed to identify and block or otherwise prevent or prohibit transactions in connection with unlawful Internet gambling. As required by the Act, the proposed rule also exempts certain participants in designated payment systems from the requirements to establish such policies and procedures because the Agencies believe it is not reasonably practical for those participants to identify and block or otherwise prevent or prohibit unlawful Internet gambling transactions restricted by the Act. Finally, the proposed rule describes the types of policies and procedures that nonexempt participants in each type of designated payment system may adopt in order to comply with the Act and includes non-exclusive examples of policies and procedures which would be deemed to be reasonably designed to prevent or prohibit unlawful Internet gambling transactions restricted by the Act. The proposed rule does not specify which gambling activities or transactions are legal or illegal because the Act itself defers to underlying State and Federal gambling laws in that regard and determinations under those laws may depend on the facts of specific activities or transactions (such as the location of the parties).

Requirements of the RFA

The RFA requires agencies to consider the economic impact that a proposed rulemaking will have on small entities. Pursuant to the RFA, the agency is required to prepare an initial regulatory flexibility analysis (IRFA) to assess the economic impact of a proposed action on small entities. Under Section 601(3) of the RFA "small business" has the same meaning as the term "small business concern" under section 3 of the Small Business Act. The IRFA must include: (1) a description of the impact of the proposed rule on small

[1] Pub. L. No. 96-354, 94 Stat. 1164 (1980) (codified at 5 U.S.C. §§ 601-612) amended by Subtitle II of the Contract with America Advancement Act, Pub. L No. 104-121, 110 Stat. 857 (1996). 5 U.S.C. § 612(a).
[2] 72 Federal Register 56680.

entities; (2) the reasons the action is being considered; (3) a succinct statement of the objectives of, and legal basis for the proposal; (4) the estimated number and types of small entities to which the proposed rule will apply; (5) the projected reporting, recordkeeping, and other compliance requirements, including an estimate of the small entities subject to the requirements and the professional skills necessary to comply; (6) all relevant Federal rules which may duplicate, overlap, or conflict with the proposed rule; and (7) all significant alternatives that accomplish the stated objectives of the applicable statutes and minimize any significant economic impact of the proposed rule on small entities.[3] In preparing its IRFA, an agency may provide either a quantifiable or numerical description of the effects of a proposed rule or alternatives to the proposed rule, or more general descriptive statements if quantification is not practicable or reliable.[4] The RFA requires the agency to publish the IRFA or a summary of the IRFA in the Federal Register at the time of the publication of general notice of proposed rulemaking for the rule.[5]

Pursuant to section 605(a), an agency may prepare a certification in lieu of an IRFA if the head of the agency certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities. A certification must be supported by a factual basis.

The Agencies' Compliance with the RFA

The agencies prepared an IRFA for the proposed rule and solicited comments from the public regarding the information in the IRFA. Advocacy, however, is concerned that the IRFA may not comply with the RFA.

The Agencies Fail to Provide Sufficient Information About the Economic Impact of the Proposed Rule

The purpose of an IRFA is to describe the impact of the proposal on small entities. Although the IRFA submitted by the agencies identifies types of small businesses that are affected by the proposal, it fails to provide information about the nature of the impact as required by the RFA. Instead, the agencies state that they do not have sufficient information and request that the information be provided by the public.

Advocacy appreciates the fact that the agencies may need to obtain information and commends the agencies for soliciting additional information from the public. However, Advocacy is concerned that the agencies are not providing all available information in the proposal. In the Supporting Statement for Recordkeeping Requirements associated with Regulation GG submitted to the Office of Management and Budget, the Federal Reserve stated that the total cost to the public is $19, 899,325. This estimate was based on an assumption that 30 percent of the work would be provided by clerical staff at $25 per hour; 45 percent would be performed by managerial or technical staff at $55 per hour, 15 percent would be performed by senior management at $100 an hour, and 10 per cent would be

[3] 5 USC § 603.
[4] 5 USC § 607.
[5] 5 USC § 603.

performed by legal counsel at $144.[6] This information was found under the reporting forms section on the Federal Reserve's website but it is not in the preamble of the proposed rule. If the agencies provided this information to the public in the IRFA, the public would be able to provide the agencies with meaningful comments about whether the assumptions about the costs are correct for small entities.

Moreover, Advocacy questions whether the projected paperwork costs are the only costs involved. In the statement, the Federal Reserve states that the estimate does not include large money-transmitting businesses because they already have systems in place. It states that smaller firms acting as agents in these large systems may be able to rely on the large system's policies and not need to establish their own policies and procedures. Will smaller firms incur legal fees in determining whether the proposed rule applies to them? If the rules do apply, will those firms incur costs to develop policies and to train their employees on the policies? These are a few of the questions that the agencies may want to consider in determining the economic impact of this regulation on small entities.

Alternatives

In addition, as noted above, the RFA requires agencies to consider less burdensome alternatives that still meet the statutory objectives. Instead of considering alternatives and providing a discussion about the economic impact of the potential alternatives, the agencies state that:

> "Other than noted above, the agencies are unaware of any significant alternatives to the proposed rule that accomplish the stated objectives of the Act and that minimize any significant economic impact of the proposed rule on small entities. The Agencies request comment on additional ways to reduce regulatory burden associated with this proposed rule."

It is unfortunate that the agencies do not put forward a meaningful discussion of alternatives in their proposal. Simply soliciting information about alternatives from small entities does not relieve the agencies of their obligation to consider less burdensome alternatives as part of the IRFA (in the proposed rule).

One alternative that the agencies may want to consider is exempting small money transmitters from the proposed rulemaking. The National Money Transmitters Association (NMTA) has informed Advocacy that the existing customer agreements and contracts with counterparties already include clauses prohibiting network use for unlawful transactions. As such, transmitting funds for an unlawful gambling activity would breach the contract. Moreover, a money transmitting business is similar to a wire transfer system in that both types of businesses operate as send agents, not financial institutions. Since a wire transfer system is exempt, the money transmitting businesses should also be exempt.

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[6] The Supporting Statement for Recordkeeping Requirements associated with regulation GG can be found at http://www.federalreserve.gov/reportforms/review.cfm. The information regarding the paperwork burden is on pages 5-6 of that statement.

Identification of Duplicative, Overlapping, or Conflicting Federal Rules

As noted above, the RFA also requires an agency to identify duplicative, overlapping, or conflicting federal rules. In this proposal, the agencies sought comment on whether there are statutes or regulations that would duplicate, overlap, or conflict with the proposed law. The RFA places the duty to identify existing regulations on agencies, not small entities. Shifting that obligation to small entities usurps the purpose of the RFA.

Conclusion

The RFA requires agencies to consider the economic impact on small entities prior to proposing a rule, to provide the information on those impacts to the public for comment, and to consider less burdensome alternatives. Advocacy encourages the agencies to prepare and publish for public comment a revised IRFA to determine the full economic impact on small entities; identify duplicative, overlapping or conflicting regulations; and consider significant alternatives to meet its objective while minimizing the impact on small entities before going forward with the final rule.

Thank you for the opportunity to comment on this important proposal and for your consideration of Advocacy's comments. Advocacy is available to assist the agencies in their RFA compliance. If you have any questions regarding these comments or if Advocacy can be of any assistance, please do not hesitate to contact Jennifer Smith at (202) 205-6943.

Sincerely,

Thomas M. Sullivan
Chief Counsel for Advocacy

Jennifer A. Smith
Assistant Chief Counsel for
Economic Regulation and Banking

cc: The Honorable Susan E. Dudley, Administrator
Office of Information and Regulatory Affairs, OMB

The Subcommittee on Domestic and International Monetary Policy
"Proposed UIGEA Regulations: Burden without Benefit?"
Wednesday, April 2, 2008

Submitted by:

Gregory A. Baer
Deputy General Counsel

Chairman Gutierrez, Ranking Member Paul and members of the Subcommittee, thank you for the opportunity to submit testimony for the record for this hearing on the proposed rule implementing the Unlawful Internet Gambling Enforcement Act of 2006 (the Act). As one the of world's largest financial institutions, providing a full range of banking, investing, asset management and other financial and risk management products and services, Bank of America has a strong interest in a workable means of implementing this rule. In 2006, the Bank processed nine billion checks, operated the largest bank-owned ATM network with over 7,000 locations, and was the largest receiver of Automated Clearing House (ACH) transactions in the United States.[1] Additionally, the Bank has over 23 million active on-line banking users and is the largest issuer of credit cards in the United States.

The Federal Reserve Board and the Department of Treasury have done an admirable job in working to develop regulations to implement a law that, by in large, was approved by Congress without the traditional level of scrutiny given to a statute that has such far-reaching effects. As this body knows, the UIGEA was approved by the Senate as part of the Port Security Act in late 2005 without the benefit of a Committee hearing or mark-up.

In our comment letter submitted to the agencies we suggested that there could be improvements to the definitions and exemptions in the proposed rule. Additionally, the proposed safe harbor provision in the rule needs to be improved to ensure that it covers instances of over blocking as well as instances where illicit transactions pass through the payments system despite efforts to intercept them. The government is in the best position to identify and publish a list of entities that are engaged in illegal internet gambling so that financial institutions can effectively block payments to and from these entities.

I. Definition Of Unlawful Internet Gambling And Other Terms Needed

The proposed rule does not define "unlawful internet gambling," and by failing to do so, hinders the ability of financial institutions to comply with the rule. The Supplementary Information in the rule states that the scope of the gambling related terms should be resolved by reference to the underlying State and Federal gambling laws. This approach is not workable for the participants in the payments system, as it grants no certainty as to what is permitted and what is not. Without an unambiguous definition of what is unlawful, financial institutions will be forced to block legitimate transactions in order to avoid the possibility of permitting an illegal transaction. This will result in costly disputes between payment system operators and participants and their clients. Some payment system operators and participants may be forced to abandon completely all services to any business that is involved in gaming activities for fear that some transactions may be deemed to be illegal. Accordingly, we recommended to the agencies that the definition of "unlawful internet gambling" include a list of the states that prohibit internet gambling, and the entities with which financial institutions are prohibited from doing business. Without this

[1] In 2006 Bank of America was the number one Receiving Depository Financial Institution (RDFI) and number two Originating Depository Financial Institution (ODFI) in the U.S. with a total of 4,365,125,476 in combined transactions.

additional direction, financial institutions will be forced to determine on their own which state or Federal laws apply to a particular transaction, which is a complicated, fact-specific determination for each transaction.

The proposed rule requires a depositary bank to set and follow certain procedures "if the depositary bank becomes aware that the customer has deposited checks that are restricted transactions." Depositary banks cannot manually inspect each check moving through the payments system to determine the purpose of the check, but even if they could, the purpose of the payment can easily be obscured by entities seeking to engage in unlawful internet gambling. A depositary bank is most likely to become aware of an illegal internet gambling transaction through notice from the government that the payee is an unlawful enterprise. In our comments to the agencies we recommended that the rule clarify that a depositary bank "becomes aware" of a restricted transaction when the bank is notified by the government of an unlawful transaction or when the payee is placed on a government-generated list of unlawful enterprises that is provided to the depositary bank.

Throughout the proposed rule, there are references to "blocking, preventing, and prohibiting" restricted transactions. It would be helpful for enterprises seeking to comply with the final rule to have a better understanding of what the agencies mean when they refer to blocking, preventing, and prohibiting and if there is any distinction among these terms. The agencies should permit the card networks (e.g. VISA, MasterCard, American Express, and Discover) and ACH associations to define these terms through their operating rules, and act by rule only if the association rules are deemed insufficient.

The definition of "card system" in the proposed regulation uses the term "operator" when determining who authorizes transactions. The term "operator" would only apply in the American Express (AMEX) or Discover proprietary models, where the issuer, acquirer, and network are owned by the same entity. In the more traditional model (MasterCard, Visa, and now AMEX & Discover Licensees), where the issuer, acquirer, and networks are different entities, the issuer is responsible for the authorization and may not have any direct relationship with the acquiring institution. The following definition of "card system" may be more appropriate for the final rule: "(d) *Card system* means a system for authorizing, clearing and settling transactions in which credit cards, debit cards, pre-paid cards, or stored value products, are used to purchase goods or services or to obtain a cash advance. The card system generally relates to a card processing model in which the merchant acquirer, the card network, and the card issuer may be separate entities, but may include a card processing model in which one or more of the entities are the same."

II. Designated Payment Systems

The list of designated payments systems in the proposed rule is appropriate; however, the description of Money Transmitting Businesses (MTBs) should be narrowed. Often financial institutions use third party agents to provide money transferring services for their online banking businesses. These agents should be excluded from the definition of an MTB. If these entities are not excluded from the definition of MTBs, the ability of customers to transfer funds electronically will be significantly slowed, and financial institutions will have to construct systems to replace the services that these agents provided. We recommend that since these companies, when acting as vendors to financial institutions, are not acting as MTBs, they be permitted to avail themselves of the same exemptions as the institutions that they are serving in order to perform their duties without threat of liability.

III. Safe Harbor Should Be Clarified And Exemptions Expanded

Safe Harbor

The proposed rule structures its safe harbor provision by including non-exclusive examples of policies and procedures that would be deemed reasonably designed to prevent or prohibit unlawful internet gambling transactions. Bank of America strongly endorses this effort, but urges the agencies to clarify this safe harbor so that banks can reasonably rely on it for protection from liability and regulatory risks. It is expected that under the proposed rule banks may inadvertently prohibit some legitimate transactions (that is, over block) and could also approve some transactions that are supposed to be blocked. The agencies should grant safe harbors for both of these inadvertent errors so long as the institution has reasonable policies and procedures in place to comply with the rule. Without this explicit safe harbor, the payments system will be slowed. The agencies should be clear that banks that establish reasonable policies and procedures to block unlawful internet transaction will not be subject to liability if a legitimate transaction is blocked or if an improper transaction is approved. The safe harbor should make it clear that in order to qualify, an institution does not have a duty to continuously monitor transactions for unlawful activity, but rather must establish reasonable policies and procedures and act when it "becomes aware of" the unlawful activity. Without this clarification, the "becomes aware of" standard leaves a financial institution in doubt of what, if any, action it would need to take in order to be covered by the safe harbor. Although the proposed rule states that it was not intended to change the legality of any gambling-related activity in the United States, if there is no such safe harbor, financial institutions will be at great risk of liability and may be forced to disengage from all gambling-related clients.

ACH and Wire Transfer

Bank of America supports the provisions in the proposed rule that grant exemptions if it is not "reasonably practical" to prevent or block a transaction. The agencies have properly exempted the originating depository financial institutions (ODFIs) of an ACH credit transaction and receiving depository institutions (RDFIs) in an ACH debit transaction and the originator's bank for a wire transfer, all based on the fact that banks do not have control over these transactions. Further, Bank of America agrees that both the Federal Reserve and EPN should be exempted since these entities pass files through the system, but do not interrogate them. However, the proposal does not exempt the ODFI in an ACH debit transaction or the RDFI in an ACH credit transaction and the beneficiary's bank in a wire transfer. There is no effective tool to monitor this transactional activity. The proposed rule seeks to require an originator to submit a statement that the ACH debit transaction is not a restricted transaction. As with the transactions that the proposed rule exempts, such a statement by an ODFI in an ACH debit transaction is of limited value, because a customer may knowingly mischaracterize the nature of the transaction, or be unaware whether a particular gambling transaction is restricted under the Act. Developing a system to obtain information and then deciding whether to reject or block a transaction is very burdensome; it would slow the payments system and any associated benefits would likely be outweighed by the costs to institutions involved. In order to preserve the efficient function of the ACH and wire transfer systems and to avoid unnecessary costs, the final rule should exempt all ACH ODFIs and RDFIs for ACH credits and ACH debits, as well as all wire transfer beneficiary banks.

Check Transactions

Bank of America agrees with the provisions in the proposed rule that exempt the clearinghouses, the paying bank, any collecting bank, and any returning bank involved in a check transaction from the requirements of the regulation. As pointed out in the Supplementary Information, banks in the collection

process handle large volumes of checks daily and typically rely on data (usually found in the MICR line of the checks) to process them. These banks do not inspect the items individually, and could not do so without creating extensive delay in the system and exponentially increasing the collection risk to banks. The exemption for most of the participants in the check collection process is necessary to keep this process operational.

The proposed rule, however, does not exempt depositary banks from coverage. Under the proposed rule, depositary banks would be required to have policies and procedures reasonably designed to prevent or prohibit restricted transactions. Depositary banks, like others in the check collection process, rely largely on the information in the MICR line to process checks on a daily basis. In 2006, Bank of America processed an average of 125 million deposits **per month**, containing 500 million checks. This considerable check volume prohibits the Bank from inspecting each deposited item manually. If checks were inspected manually, the payments system would be severely impeded, and depositary banks would encounter the same obstacles that the agencies acknowledge would face paying banks: " . . . even if the payee information on checks is analyzed manually, it is very difficult for a paying bank to determine whether the check is related to a restricted transaction."[2] While depositary banks are required to have more knowledge about their own customers than other banks in the collection chain, it does not follow that a depositary bank would have any more information about the *purpose* of a transaction relating to a *particular check*. This is doubly important because, as discussed above, the proposed rule fails to define what constitutes "unlawful internet gambling."

It would take a great deal of information about the purpose of a transaction behind any particular check, as well as an extensive knowledge of state, federal and tribal law to be able to determine whether any particular check relates to "unlawful internet gambling." This is not information and knowledge that individuals processing checks at a depositary bank are likely to have. Depositary banks should be exempted from this rule since they will not have the ability to identify the purpose of the check transaction with any greater certainty than other participants in a check transaction. Further, convenience checks and ACH payments made or issued in connection with credit card accounts should be subject to the same exemptions the proposed rules grant to paper checks and ACH vehicles. It is extremely difficult to distinguish convenience checks and ACH payments connected to credit card accounts from those that are not connected to such accounts.

IV. Processing Restricted Credit Card Transactions

The proposed rule requires all non-exempt participants in the designated payment systems to establish and implement policies and procedures to identify and block, or otherwise prevent or prohibit, restricted transactions. While the overall intent of this provision should be to mirror processes that exist in the major card networks (Visa, MasterCard, American Express, Discover), the proposed language fails to distinguish between the separate and distinct roles that the various non-exempt participants play in being able to support identification and blocking.

The credit card payments system generally requires participation from four different parties who each play a distinct role in preventing the processing of illegal internet gaming transactions:

(1) the merchant - initiates and submits the transaction a certain way impacting the transaction indicators;

(2) the acquiring bank - establishes transaction indicator requirements with merchants and provides authorization and settlement services among merchants;

[2] The Federal Reserve Board and the Department of Treasury, Notice of Proposed Rule Making, 31 CFR Part 132, (p. 16).

(3) the card network - establishes the policies and procedures for identification and blocking and first detects a transaction's coding; and
(4) the card issuer - provides authorization for non-restricted transactions.

Each party plays a critical role in facilitating merchant transactions, but they do not all have the same ability to identify and block a restricted transaction. In order for an issuer to recognize a transaction as "restricted" prior to authorization, it must rely solely on merchant category code (MCC) and transaction indicators provided by the merchant. At the time it initiates a transaction, the issuer would have to examine both the MCC from a gambling merchant (MCC 7995) and a separate internet transaction indicator, the combination of which would reasonably indicate internet gambling. The MCC and the transaction identifier simply indicate that there is a gambling transaction over the internet, not whether that transaction is legal or illegal. For example, the following elements on the same transaction indicate internet gambling:

MasterCard:
MCC 7995 [Gambling]
Data Element 22, subfield 1, value = 80 [Internet Transaction Indicator]

Visa:
MCC (Field 18) = 7995 [Gambling]
Processing Code (Field 3) = 11 [Quasi-Cash/Online Gambling]
POS Condition Code (Field 25) = 01, 08, 59 [E-commerce transaction]

Both MasterCard and Visa use the same MCC, but they use different transaction identifiers, neither of which addresses the question of legality. If the merchant does not properly process the transaction or the transaction does not require an authorization, the card network (or issuer) would have no ability to identify and block the transaction and could not reasonably be expected to do so. On the other hand, while acquirers monitor their merchants to ensure they comply with the transaction parameters established at the time the merchant's account was set up, they do not have the functionality to view transactions in real–time, and only see transactions *after* an authorization has been received from an issuer. Reliance on the MCC is subject to the same limitations as check, ACH, and wire transactions in that a customer or a merchant can knowingly mischaracterize the true nature of the transaction, without the network or the issuer being aware of the mischaracterization.

The only party who is in a position to determine whether or not the transaction is restricted under federal, state, intratribal, intrastate betting, or intrastate horseracing laws is the merchant. While acquirers can establish policies and procedures to ensure terminals are programmed for the appropriate MCC, without a list designating companies that are known to engage in illegal internet gambling activities, none of the parties has the resources to know the many state laws; nor would they know where a transaction is "initiated, received or otherwise made" to determine whether it was unlawful. In addition, issuers, and card networks are not able to make determinations based on the information received (MCC or transaction indicators) and would also have no way of knowing if the merchant is engaging in a legal or an illegal transaction at its particular location. Reliance on MCC codes will not be sufficient, as their assignment is controlled by the merchants or the card network. Issuing banks and other depository institutions have no ability to determine how particular codes will be assigned. Additionally, since these transactions are unlawful to begin with, it would be safe to assume that users would be willing, and easily able, to improperly process transactions to prevent identification of their true nature.

Bank of America recommends recognition of the distinct roles played by the actors in a card transaction and supports a process that would require the payment networks to serve as the primary entities responsible for both the policies and operational procedures and the identification and blocking of

restricted transactions that would occur before being presented to an issuer. In addition, the networks should be urged to create a consistent and uniform standard so that the participating members are not placed in a position of evaluating differing policies and procedures to determine compliance. The agencies should review and approve such plans once they have been created and provide a strong safe harbor for participants who rely on them. The networks should not be permitted to charge association members or licensees for compliance with the agencies' regulations.

Today, when the Office of Foreign Assets Control (OFAC) prohibits transactions with a country, the card networks prohibit all transactions within these countries before transactions are received by the issuer. A similar structure would be the most effective and efficient way to prevent illegal internet gambling.

V. Policies and Procedures

Bank of America generally supports the suggested provisions set forth in this section with the following specific suggestions:

Merchant/Customer Due Diligence. Bank of America has specific policies in place to identify a merchant's business activity. Account opening applications allow a bank to obtain specific information about the merchant that indicate the nature of its business and types of transactions on which it wishes to accept card payments, wire transfers, or engage in ACH transactions. Bank of America currently takes a risk-based approach to establish that a merchant does not itself perform, or have relationships with other merchants known to perform, gaming transaction via the Internet. In addition, applicants that indicate that they will be accepting payments over the Internet are subject to enhanced due diligence in the form of an investigation of their web site content including links contained on its web pages. However, requiring banks to continuously monitor and review the activities of their clients without the use of a specific list of enterprises engaged in unlawful internet gambling will not achieve the goals of this proposed rule. Entities that seek to engage in illegal activity will not identify that they are engaged in such activity.

Remedial Action. We propose that the banks be permitted to establish risk-based remedies depending on severity, volume and type of non-compliant action. We have provisions in our customer agreements that permit us to terminate the relationship for improper use of the account. All banks should be permitted to make risked-based decisions as to whether to terminate or not terminate a customer and should be considered compliant, as long as they are taking reasonable steps to block transactions. With regard to fines for improper activity, the card networks and other payments associations are the appropriate entities to be charged with the duty of imposing fines for improper activity by merchants.

Cross Border Transactions. The agencies should clarify the intent of this section of the rule. There is no information embedded in a cross border wire transfer, credit card transaction or ACH transfer that would let a bank know the purpose of a transaction and, given the complexity of the question of what is legal and illegal, it is be impossible to judge whether such a transaction would be restricted or not. To block illegal cross border transactions, a bank would have to rely on: 1) information within the transaction if provided by the originator; or 2) a list of blocked organizations. The originator is unlikely to be helpful in this regard. The responsibility for policing cross border transactions is more complex than policing transactions occurring completely in the U.S. because it is difficult to identify merchants off-shore, and international jurisdictions often permit internet gambling transactions. Additionally, it is unclear what a U.S. bank would be expected to do if a transaction that was legal in the countries of the sender and recipient traveled though the U.S. prior to payment. To require a U.S. based bank to discover and then block this type of transaction would be unreasonable and place an extreme burden on the payments system. Finally, since it is not possible to determine the purpose of a wire transfer, the agencies should make it clear that intermediary banks are exempted.

List of Unlawful Internet Gambling Businesses. This section of the proposed rule lays out precisely why financial institutions cannot with any degree of certainty identify, block or even accurately monitor unlawful internet activity. This regulation was proposed based on research that indicated that most unlawful gambling businesses operate offshore and have no direct relationships with U.S. financial institutions. As such, the U.S. Government is best positioned to provide information on targeted entities operating illegal businesses and to work to prevent those conducting legitimate transactions from being unfairly penalized. The payments system does not have the capability to limit identification and blocking to only those entities meeting the restricted transaction definition without being provided company/entity names to monitor against. The agencies identify some practical concerns in upkeep and execution; however, they are not different than the concerns that the card, ACH, wire, and check system participants encounter in their obligations under the proposed rules. We believe that the resource time and cost is much greater for private enterprises than it would be for the government to provide such a list and could leverage the existing process the government has for the management of the OFAC list. Further, the government grants entities that are placed on the OFAC list some due process rights to contest their listing. No such rights exist when transactions or entities are blocked by financial institutions. We therefore support the establishment and maintenance of a list by the government to be used by financial institutions in a similar manner as the OFAC list, coupled with a safe harbor for those that block transactions with the listed entities.

Cost/Benefit. The agencies will be placing a substantial burden on financial institutions and the payments system if they require banks to actively monitor accounts for unlawful internet gambling activity. Banks will be forced to redesign their account opening systems and maintenance systems as well as warehouse the responses received from customers. For Bank of America these additional changes could result in hundreds of millions of dollars in additional costs for limited, if any, benefit. Additionally, consumers could face payment processing delays or the blocking of legitimate transactions if banks are required to monitor all of these financial transactions. As mentioned above, inquiries from banks to entities seeking information regarding unlawful activities will not likely result in responses indicating such activity is occurring, so the burdens of this proposal greatly outweigh any potential benefits.

VI. Conclusion

Thank you for the opportunity to present Bank of America's views on the proposed rules implementing the UIGEA. In order to prevent undue burdens on the payments system, it will be critical for the agencies to improve and clarify the definition of unlawful internet gambling and establish unequivocal safe harbors for both over blocking and under blocking. Further, in addition to the exempted participants cited in the rule, the ODFI for ACH debits and the RDFI for ACH credits, beneficiary banks for wire transfers, and depository banks for check transactions should all be exempted from these rules since efficient systems do not exist to monitor these transactions for unlawful internet gambling activity. Finally, MCCs for card transactions are not useful tools for issuers to identify illegal internet gambling transactions. We respectfully submit that the most effective method to halt illegal internet gambling would be for the government to establish a list of entities that engage in such activities and require financial institutions to use this list to block access to the payments system.

Testimony of Joseph H. H. Weiler

Professor of Law

Director, Jean Monnet Center for International and Regional Economic Law & Justice

New York University School of Law

U.S. House of Representatives

Sub-Committee on Domestic and International Monetary Policy, Trade and Technology. April 2, 2008

Written Statement by Professor JHH Weiler

My name is Joseph Weiler. Since 2001 I have served as Professor of Law and Director of the Jean Monnet Center for International and Regional Economic Law & Justice at NYU School of Law. Prior to that, from 1992 till 2001, I was Manley Hudson Professor of International Law at Harvard Law School and before that a Professor of Law at the Michigan School of Law.

One area of my expertise is the law of the WTO. I have served on occasion as a WTO Panel Member. I attach to this Statement a full resume.

Recently I have been retained, and continue to be retained, by several Law Firms whose clients include individuals and corporations who have been indicted or are threatened by the US under the Wire Act and other related acts for offering remote internet betting services from outside the United States. I was asked to provide them with independent expert advice on, *inter alia*, the compatibility of such indictments with US international legal obligations and more generally with the compatibility of the overall US ban on remote betting from providers located outside the US in countries which are Member States of the WTO.

In this Written Statement I want to summarize my principal conclusions and recommendations.

1. The United States in recent years, through executive and legislative means, has put in place a policy banning the provision of remote betting by overseas service providers. Some of these providers are corporations and individuals hailing from America's closest allies. The ostensible justification for this action was the protection of the public from various ills which remote betting allegedly generates.

2. As is now well known, this ban was found to violate the commitments which the United States had voluntarily given to its WTO partners under the GATS Agreement. The WTO regime (of which the United States is one of the principal architects and a major 'player') is often depicted as encroaching on US "sovereignty" and internal autonomy in an unacceptable way. Remote betting is cited as such an example. In fact, in the case of remote betting (as in all other cases) the US has full legal authority under the WTO/GATS to regulate the industry so as to protect the public against any risks. If the US considered it wise it could even impose a total ban. But what it cannot do is to regulate or ban in a discriminatory manner. Under its WTO obligations the US cannot regulate or ban in a manner which slyly supports and allows domestic providers of remote betting but bans providers from WTO partners. And yet, all judicial instances in the WTO found that this is exactly what the US has been doing and continues to do till this day. The WTO found, that whereas the US was trying to justify its ban on outside providers of remote betting services by considerations of public policy and public order it allowed at the very same time within the USA the operation of

> "... substantial and even prominent businesses, with, collectively, thousands of employees and apparently tens of thousands of clients, paying taxes or generating revenue for government owners, having traded openly for up to 30 years and in some cases even operating television channels.... The evidence regarding the suppliers demonstrates the existence of a flourishing remote account wagering industry on horse racing in the United States operating in ostensible legality."

The conduct of the Executive Branch in banning outside providers is not just discriminatory and thus in violation of the WTO, but one cannot escape the suspicion that it might be motivated in part by a protection of special interests within the United States rather than protection of consumers.

3. Having lost all its cases before the WTO, instead of complying with the judicial decisions against it the US has taken steps to withdraw its GATS commitment in this area and pay compensation to its trading partners. Withdrawal of a commitment voluntarily

given in the face of an adverse judicial decision (confirmed by the WTO Appellate Body) is unprecedented. It is regarded by many as a cynical manipulation of the system – you lose the game, so you change the rules. It also charts a way and creates a political precedent which might harm US interests when other countries emulate such behavior.

4. Further, to this day, the US Executive Branch persists in maintaining indictments and threatening indictments that are based on domestic laws the application of which to defendant in these circumstances is in clear and egregious violation of the US international obligations. The US prosecutors pursuing these actions defend themselves by relying on the ground that their internationally illegal actions are shielded by the Uruguay Round Implementing Act from suits by individuals in domestic US courts. The approach of these prosecutors amounts to the following: 'What we are doing may be illegal under international law, but you, the individuals cannot do anything about it, because under our reading of the Uruguay Round Agreement Act we are immune.'

5. Even if the URAA gave such immunity to the Executive Branch – which I do not believe to be the case – this approach amounts to a spectacular contempt for the rule of international law and to American notions of fairness and justice. Specifically, the conduct of US prosecutors in maintaining these discriminatory prosecutions targeting corporations and individuals who are nationals of friendly allies, subjecting them to oppressive plea bargains, and retroactively seeking to criminalize conduct which was protected under international law at the time it took place, is not simply a violation of WTO/GATS obligation but amounts, it is respectfully submitted, to a Denial of Justice under international law. We would all be indignant if any other country dared to treat US Citizens in similar fashion under similar circumstances.

6. The conduct of the Executive Branch is harmful to the United States in many ways.

- Our economy relies more and more on a robust exporting sector – both in goods and services. The WTO including the GATT and GATS are the principal legal framework which guarantees US businesses a discrimination-free environment in

which to sell their products and services in other WTO countries. Imagine that a foreign country took a commitment which, say, allowed American hospitals and doctors access to offer medical services. Imagine further that based on that commitment the US hospitals and doctors began offering services in a WTO Member. Imagine now that this country failed to live up to its commitment and imprisoned American doctors on the ground that a national law forbade the offering of such services to doctors not trained in the host country. We would be rightly outraged. We would be even more outraged if that country turned to the American doctors and said: though we acknowledge that our actions are in violation of our agreement, according to our internal law, you have no recourse. You sit in jail. But what would we say if that country turned around and said – We are only following the example of the United States of America. Our outrage would at this point turn not against such a country but against our own Executive Branch.

- We should be equally concerned by the move of the Executive Branch to withdraw US Commitments – an action which, to the best of my knowledge, was done without consultation or authorization by Congress. What the US should have done was to bring our law and conduct into compliance with our international legal obligations on which many countries and individuals have relied rather than renege on its promises. This is not simply or even primarily a moralistic point. Our country is the trendsetter and leader in so many international arenas. Whether we like it or not, *we lead by example.* As our economy moves increasingly towards a high tech, knowledge based service oriented model and as we realize that our future prosperity will depend increasingly of tapping into export markets, notably the huge emerging markets such as China and India, is it really in our self interest to teach this particular example? When you are caught denying access or discriminating against American businesses in violation of your GATS or GATT obligations, rather than complying, simply withdraw your commitment and change your promise?

- The United States justly used to enjoy a world reputation as a champion of liberty, rights and the rule of law. I think it is acknowledged by all political forces that in recent times this reputation has been seriously diminished compromising American leadership and American interests. In some areas, notably in the area of the war on terror and national security, there might be a feeling that existing rules of international law compromise the ability of the United States effectively to defend itself. I make no pronouncement on that. But if this is the case, it would seem to me that in all other areas, where national security is not involved, this country would be well served if its Executive Branch was particularly vigilant and scrupulous in observing the rule of law, which includes a respect for international legal obligations. This is, too, in the interest of the United States. It should be recalled that United States signed and supported the WTO Dispute Resolution Understanding which provides, *inter alia*, in Article 17.14

> An Appellate Body report shall be adopted by the DSB and *unconditionally accepted by the parties to the dispute* unless the DSB decides by consensus not to adopt the Appellate Body report within 30 days following its circulation to the Members." (emphasis added)

Article 21.1 of the DSU provides in turn:

> Prompt compliance with recommendations or rulings of the DSB is essential in order to ensure effective resolution of disputes to the benefit of all Members

It should also be recalled that the United States is often on the winning side of Trade Disputes, and when it is on the winning side it insists vigorously that its trading partners faithfully comply with their legal obligations.

To give but one example: In its famous dispute with the European Union as regards exportation of Meat Hormones, the US won its case. Here are the words of the representative of the US in the WTO:

> "The representative of the United States said that this was an important juncture in the dispute settlement process. Her delegation welcomed the [European Union's] statement. It was important for the integrity and viability of the dispute settlement mechanism that Members complied with the DSB's recommendations. In this case, the Communities' obligations were clear. In accordance with the rulings, the ban had not been supported by scientific evidence nor by any of the risk assessments presented during the proceedings. All the risk assessments that had been conducted had proved that the six hormones in question were safe. This meant that compliance with the DSB's recommendations required the Communities to remove the ban on the importation of meat produced with the use of any of the six hormones to promote growth."

The matter this Committee is considering is not about National Security; the US Executive Branch is the custodian of the United States national interest. It is not in American interest to weaken the ability of the United States to insist on prompt compliance with WTO rulings by others.

7. When a Member fails to comply with a decision of the WTO Appellate Body and Dispute Settlement Body, it opens itself to trade sanctions by the winning country in the form of withdrawal of concessions. This has been interpreted by some to suggest that as long as the US was willing to submit itself to such sanctions, it was discharging its obligations under the WTO system. This is an utter misconception of the system. The withdrawal of concessions are meant to be a sanction and incentive for a recalcitrant Member to fulfill its obligation, not an indulgence you buy to expiate your wrong doing. To argue otherwise would be the equivalent of a rich man claiming that as long he was willing to pay the fine, he was under no legal obligation to move the car he parked in front of a fire hydrant.

8. In many of its utterances the Executive Branch has taken the position that it is defending the "sovereignty" of the United States as a whole, and that in its conduct in this matter it is executing the will of Congress. I respectfully and vigorously dispute both these propositions. When a country solemnly adopts an international legal obligation and then honors that obligation it does not compromise its sovereignty – it manifests its sovereignty. For generations the United States has taken the view that all Congressional Acts should, if at all possible, be interpreted and applied in such a way as to respect international obligations solemnly undertaken by this Country. We expect the same from all other countries. The Executive Branch is doing no service to the US by violating these obligations, and laying the responsibility at the feet of Congress. Congress should not allow such.

9. As I indicated above, it is clear that remote betting over the internet does pose various legitimate concerns. There are potential hazards to, for example, consumers which do not exist in on-site gambling. If the United States were to adopt a "prohibition mentality" the WTO would not prevent the US from banning all such betting provided such a ban could be justified on grounds of public policy and public morality and was applicable to *all* remote betting, internal and external. I do not think such a total ban is either wise or likely. The alternative is to adopt a regulatory regime which would address the hazards of remote betting and would apply with no discrimination both to domestic and foreign service providers from our WTO partners. In this way the US would both address its legitimate social concerns and respect its international legal obligations.

J.H.H. Weiler

Biographical Sketch

J.H.H. Weiler is University Professor at New York University and European Union Jean Monnet Chair at NYU School of Law. Professor Weiler is Director of the Jean Monnet Center for International and Regional Economic Law & Justice at NYU.

Previously he served as the Manley Hudson Professor of International Law at Harvard Law School.

He is, too, Visiting Professor at London School of Economics; Honorary Professor at University College, London; Honorary Professor at the Department of Political Science, University of Copenhagen and Co-Director of the Academy of International Trade Law in Macao, China.

He is a Fellow of the American Academy of Arts and Sciences.

He is part of the groups of Reporters of the American Law Institute's project International trade: WTO.

He holds degrees from Sussex (B.A.); Cambridge (LL.B. and LL.M.) and The Hague Academy of International Law (Diploma of International Law); he earned his Ph.D. in European Law at the EUI, Florence. He is recipient of Doctorates *Honoris Causa* from London University from Sussex University and from the University of Macerata and is Honorary Senator of the University of Ljubljana.

He has been Visiting Professor at, among others, the University of Paris, the Institut d'Etudes Politiques de Paris (Science Po), the Hebrew University of Jerusalem, the Max Planck Institute for International Law at Heidelberg, All Souls College, Oxford, Chicago Law School, Stanford Law School, Yale Law School, the Ortega Y Gasset Institute, Madrid, the University of Toronto, the University of Frankfurt and the University of Ljubljana.

He served as a Member of the Committee of Jurists of the Institutional Affairs Committee of the European Parliament co-drafting the European Parliament's Declaration of Human Rights and Freedoms. He was a member of the *Groupe des Sages* advising the Commission of the European Union on the 1996/97 Amsterdam Treaty. He was a member of the Advisory Group of the Greek Presidency of the European Union during the negotiations of the Constitutional Treaty and has been an advisor to several governments of Member States of the European Union.

He is a WTO Panel Member and a NAFTA Panel Member (Ch. 11).

He is a founding Editor of the European Journal of International Law, of the European Law Journal and of the World Trade Review.

He is a Member of the Advisory Boards or Scientific Committees of the Journal of Common Market Studies, Cahiers de Droit Européeen, Common Market Law Review, European Foreign Affairs Review, the Maastricht Journal of European and Comparative Law, World Trade Review, the Columbia Journal of European Law, the Harvard International Review, the Harvard Journal of International Law, the (Australian) Federal Law Review, the Journal of European Integration, the European Foreign Policy Bulletin online, ELSA-Selected Papers of European Law, the Irish Journal of European Law, the Slovenian Law Review, IMT Lucca Institute for Advanced Studies, and the Institute for International Law and Security Studies at the University of Minnesota. He is a Member of the Board of Management of the European Research Paper Archive. He is on the Board of Directors of the American Journal of International Law. He is also a Member of the Scientific Advisory Board of the Asia-Pacific Journal of EU Studies.

He is a Council Member of the Centre for European Economic and Public Affairs, University College, Dublin, a Member of the Board of the Centre for the Law of the European Union at University College, London, Member of the International Advisory Board, Queen's University, Belfast, U.K. and at the Ortega Y Gasset Institute, Madrid, Spain. He is Member of the Advisory Council of the Interdisciplinary University Center, Herzelia, Israel. He is Member of the Advisory Board of the Center for International, Comparative Law, The Dickinson School of Law, PennState and Member of the International Council of the Institute for Global Legal Studies, Washington University School of Law, St. Louis and a board member of the Scientific Advisory Board at the Max-Planck-Institute fuer auslaendisches oeffentliches Recht und Voelkerrecht in Heidelberg, Germany. He is a Member of the International Advisory Board of the Contemporary Europe Research Centre of the University of Melbourne, Australia and a Member of the International Board of the Concord Research Center at the College of Management, Israel. He is a Council Member of the Association for Hebraic Studies, AHS Institute, USA. He is a Member of the International Advisory Panel of the National University of Singapore. He is a Member of the Advisory Board of the Instituto de Empresa Business School, in Madrid, Spain.

He is author of articles and books in the fields of International, Comparative and European law. His publications include *Un'Europa Cristiana: Un saggio esplorativo,* (BUR Saggi, Milano, 2003 – translations into Spanish, Polish, Portuguese, German, Dutch, Slovenian and French) *The EU, the WTO, and the NAFTA: Towards a Common Law of International Trade?* (Oxford Univ. Press, 2000) *The European Court of Justice*. Edited with Grainne de Burca, (Oxford Univ. Press, 2001).

NATIONAL ASSOCIATION OF ATTORNEYS GENERAL
2030 M Street, 8th Floor
WASHINGTON, D.C. 20036
Phone (202) 326-6259
Fax (202) 331-1427
http://www.naag.org

CHRISTOPHER TOTH
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IMMEDIATE PAST PRESIDENT
THURBERT BAKER
Attorney General of Georgia

November 30, 2007

Via Facsimile

The Honorable Nancy Pelosi
Speaker
U.S. House of Representatives
H-232, The Capitol
Washington, D.C. 20515

The Honorable John Boehner
Minority Leader
U.S. House of Representatives
H-204, The Capitol
Washington, D.C. 20515

The Honorable Harry Reid
Majority Leader
United States Senate
S-221, The Capitol
Washington, D.C. 20510

The Honorable Mitch McConnell
Minority Leader
United States Senate
S-230, The Capitol
Washington, D.C. 20510

To the Leadership of the U.S. House of Representatives and Senate:

We, the Attorneys General of our respective States, have grave concerns about H.R. 2046, the "Internet Gambling Regulation and Enforcement Act of 2007." We believe that the bill would undermine States' traditional powers to make and enforce their own gambling laws.

On March 21, 2006, 49 NAAG members wrote to the leadership of Congress:

> We encourage the United States Congress to help combat the skirting of state gambling regulations by enacting legislation which would address Internet gambling, while at the same time ensuring that the authority to set overall gambling regulations and policy remains where it has traditionally been most effective: at the state level.

Congress responded by enacting the Unlawful Internet Gambling Enforcement Act of 2006 (UIGEA), which has effectively driven many illicit gambling operators from the American marketplace.

But now, less than a year later, H.R. 2046 proposes to do the opposite, by replacing state regulations with a federal licensing program that would permit Internet gambling companies to do business with U.S. customers. The Department of the Treasury would alone decide who would receive federal licenses and whether the licensees were complying with their terms. This would represent the first time in history that the federal government would be responsible for issuing gambling licenses.

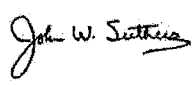
A federal license would supersede any state enforcement action, because § 5387 in H.R. 2046 would grant an affirmative defense against *any* prosecution or enforcement action under *any* Federal or State law to any person who possesses a valid license and complies with the requirements of H.R. 2046. This divestment of state gambling enforcement power is sweeping and unprecedented.

The bill would legalize Internet gambling in each State, unless the Governor clearly specifies existing state restrictions barring Internet gambling in whole or in part. On that basis, a State may "opt out" of legalization for all Internet gambling or certain types of gambling. However, the opt-out for *types* of gambling does not clearly preserve the right of States to place *conditions* on legal types of gambling. Thus, for example, if the State permits poker in licensed card rooms, but only between 10 a.m. and midnight, and the amount wagered cannot exceed $100 per day and the participants must be 21 or older, the federal law might nevertheless allow 18-year-olds in that State to wager much larger amounts on poker around the clock.

Furthermore, the opt-outs may prove illusory. They will likely be challenged before the World Trade Organization. The World Trade Organization has already shown itself to be hostile to U.S. restrictions on Internet gambling. If it strikes down state opt-outs as unduly restrictive of trade, the way will be open to the greatest expansion of legalized gambling in American history and near total preemption of State laws restricting Internet gambling.

H.R. 2046 effectively nationalizes America's gambling laws on the Internet, "harmonizing" the law for the benefit of foreign gambling operations that were defying our laws for years, at least until UIGEA was enacted. We therefore oppose this proposal, and any other proposal that hinders the right of States to prohibit or regulate gambling by their residents.

Sincerely,



John Suthers	Bill McCollum	Douglas Gansler
Attorney General of Colorado	Attorney General of Florida	Attorney General of Maryland

Troy King
Attorney General of Alabama

Talis J. Colberg
Attorney General of Alaska

Terry Goddard
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Attorney General of West Virginia

J.B. Van Hollen
Attorney General of Wisconsin

Bruce A. Salzburg
Attorney General of Wyoming

Alexander M. Waldrop
President & CEO

December 11, 2007

Mr. Charles Klingman
Deputy Director
Office of Critical Infrastructure Protection and Compliance Policy
U.S. Department of the Treasury
Room 1327, Main Treasury Building
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Comments to Notice of Joint Proposed Rulemaking, Prohibition on Funding Unlawful Internet Gambling: Docket Treas-DO-2007-0015; Docket Number R-1298

Dear Mr. Klingman and Ms. Johnson:

On behalf of the National Thoroughbred Racing Association (NTRA), I appreciate the opportunity to present comments on the proposed rule required by the Unlawful Internet Gambling Enforcement Act of 2006 (UIGEA).

The NTRA is a non-profit trade association representing more than 75 United States pari-mutuel Thoroughbred horseracing tracks and advance deposit wagering service providers that collectively handle approximately 85 percent of all monies wagered on U.S. Thoroughbred horse races.

As such, the subject addressed by the proposed rule is of vital importance to the NTRA and the horseracing industry. Internet-based wagers placed on pari-mutuel horseracing, as authorized under the Interstate Horseracing Act of 1978 (15 U.S.C. 3001 et seq.) (IHA), are a significant and rapidly growing portion of the state licensed and regulated

NATIONAL THOROUGHBRED RACING ASSOCIATION
2525 Harrodsburg Road, Lexington, Kentucky 40504
Phone: (859) 422-2602 *Fax:* (859) 296-5202 *E-mail:* awaldrop@ntra.com *Internet:* www.ntra.com

transactions engaged in by our industry. In recognition of this, the statutory language of UIGEA requires that the regulations being issued under this rulemaking ensure that these transactions not be blocked or otherwise prevented.

We understand the challenges associated with developing this proposed rule and are appreciative of the efforts devoted to producing it. Based upon our careful review of the proposed rule, we have two specific comments. First, given the exclusion of any activity that is allowed under the IHA from the definition of the term "unlawful internet gambling" under 31 U.S.C. 5362(10)(D)(i), we believe the second sentence of §2(t) of the proposed rule faithfully carries out this statutory requirement. Second, although we believe the intent of the language in §5(d) of the proposed rule is to ensure, as 31 U.S.C. 5364 requires, that transactions in connection with any activity excluded from the definition of "unlawful internet gambling" under 31 U.S.C. 5362(10)(D)(i) are not blocked or otherwise prevented or prohibited under the prescribed regulations, we would urge you, in response to your request for comments on implementing the overblocking provision, to amend §6(c) of the proposed rule as follows:

(1) delete "; and" at the end of paragraph (2)(ii)(C) and insert ";";
(2) delete the period at the end of paragraph (3)(ii) and insert "; and"; and
(3) add at the end the following new paragraph:

> "(4) With respect to any activity that is allowed under the Interstate Horseracing Act of 1978, rely upon a merchant category code (MCC) that is limited only to activities allowed under such Act.".

This amendment would make clear that, in addition to the examples set forth in paragraphs (1), (2), and (3) of §6(c) of the proposed rule, the policies and procedures of a card system operator, a merchant acquirer and a card issuer are deemed to be reasonably designed to prevent or prohibit restricted transactions if, with respect to any activity that is allowed under the IHA, such operator, merchant acquirer or card issuer relies upon an MCC that is limited only to activities allowed under such Act.

Thank you for the opportunity to provide our comments.

Sincerely,

Alexander M. Waldrop
President and Chief Executive Officer

Statement for the Record – Congressman Pete Sessions (TX-32)
Member (on-leave) of House Committee on Financial Services

Subcommittee on Domestic and International Monetary Policy, Trade, and Technology Hearing
"Proposed UIGEA Regulations: Burden without Benefit?"
Wednesday, April 2, 2008

Chairman Gutierrez, Ranking Member Paul, and Members of the Subcommittee – I appreciate the opportunity that you are extending to me to participate in this hearing as an on-leave member of the Financial Services Committee and as a Member of Congress who is greatly interested in how the regulations regarding the Unlawful Internet Gambling Enforcement Act (UIGEA) are drafted and enforced.

Like every Member of this committee, I believe that the accurate and faithful application of our nation's laws is of the utmost importance, and I understand the important role that clear and consistent federal regulations play in achieving this goal. However, when regulatory guidance is vague, an unintended consequence can be the suppression of legitimate commerce caused by a regulated community exercising an unnecessary abundance of caution.

To prevent this from happening in the case of UIGEA, on December 12, 2007, along with 15 other Republican Members of Congress, I wrote a letter to Treasury Secretary Paulson and Federal Reserve Board Chairman Bernanke urging them to ensure that the guidance provided by their agencies is clear and consistent – particularly in the case of what constitutes an "unlawful Internet gambling" transaction and how companies are expected to comply with the "blocking, preventing and prohibiting restricted transactions" mandates referenced throughout the rule.

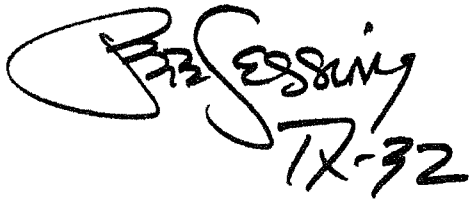
I was, and remain, concerned that the proposed rule does not designate precisely what sorts of transactions must be blocked by financial institutions and payment systems. The preamble to the regulation cites the difficulty of evaluating every federal and state law with respect to every possible form of gambling as the reason not to do this; nevertheless, the proposed rule would instead lay that exact burden on the general counsel of every bank, credit union, credit card network and money-transmitting business in the country.

The unintended consequence of this lack of clarity will be for many financial institutions to block broadly anything which may in any way resemble gambling, be it legal or illegal. Indeed, I understand that the providers of online skill games are already having difficulty with payment processing, as banks have already begun to exercise an abundance of caution to avoid potentially violating either the law or the unclear regulation.

I urge today's witnesses and the Members of this panel, prior to issuing a final rule, to determine precisely what transactions payment systems are required to block. I understand that Senators John Sununu and Domenici have written a letter to both Secretary Paulson and Chairman Bernanke suggesting that they consider "separating the rules into those forms of activities for which there is settled federal law (i.e., defined by the Professional and Amateur Sports Protection Act (PAPSA)) and those that are not." While this is certainly one approach to solving

the problem, some state-by-state determination of precisely what transactions payment systems are required to block should be a prerequisite to finalizing any rule on this issue.

I thank the Committee for the opportunity to provide this input in the process, and I ask unanimous consent that the letter that I sent to Secretary Paulson and Chairman Bernanke be inserted in the record.



Congress of the United States
Washington, DC 20515

The Honorable Henry M. Paulson
Secretary of the Treasury
U.S. Department of the Treasury
1500 Pennsylvania Ave. NW
Washington DC, 20220

The Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave NW
Washington, DC 20551

December 12, 2007

Dear Secretary Paulson and Chairman Bernanke:

As Members of Congress who are interested in the accurate and faithful application of our nation's laws, we understand the important role that clear and consistent federal regulations play in fostering economic growth and marketplace competition. At their best, federal regulations provide explicit guidance to a regulated community while also providing important consumer protections.

However, when regulatory guidance is vague, an unintended consequence is often the suppression of legitimate commerce through an abundance of caution exercised by an unsure regulated community. **We are writing to ensure that this does not become the case regarding the Notice of Proposed Rulemaking pursuant to the Unlawful Internet Gambling Enforcement Act, issued by your two agencies on October 1, 2007.**

Notwithstanding the policy disagreements surrounding the underlying issue of internet gaming, we agree that it is always the federal government's responsibility to encourage clear regulatory guidance. It appears to us that in this case, the proposed rule governing this area of law is overly broad and does not provide the regulated industry with sufficiently clear and consistent guidance.

Specifically, we are concerned that in the proposed rulemaking, your agencies could do more to clarify what constitutes an "unlawful Internet gambling" transaction and how regulated communities are expected to comply with the "blocking, preventing, and prohibiting restricted transactions" mandates referenced throughout the rule.

As you know, the statute and the proposed rule require financial institutions and payment systems to take steps to block certain unlawful Internet wagers, and exempt from the statute's effect certain classes of wagers, such as wagers accepted in compliance with the Interstate Horseracing Act, and intrastate wagers accepted by state-licensed entities.

However, the proposed rule does not seem to designate precisely what sorts of transactions must be blocked by financial institutions and payment systems. The preamble to the regulation cites

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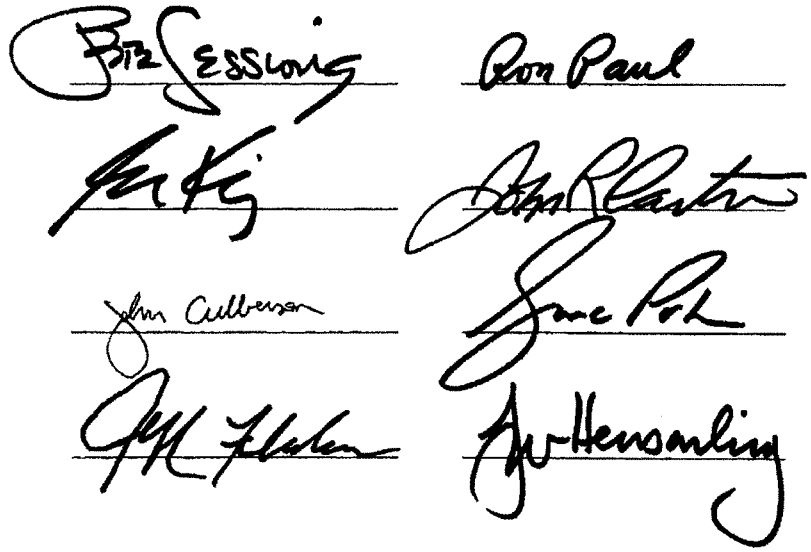
the difficulty of evaluating every federal and state law with respect to every possible form of gambling as the reason not to do this; nevertheless, the proposed rule would instead lay that exact burden on the general counsel of every bank, credit union, credit card network and money-transmitting business in the country.

We believe that the unintended consequence of this lack of clarity will be for many financial institutions to block broadly anything which may in any way resemble gambling, be it legal or illegal. Indeed, it has come to our attention that the providers of online skill games are already having difficulty with payment processing, as banks have already begun to exercise an abundance of caution to avoid potentially violating either the law or the unclear regulation.

Mr. Secretary and Mr. Chairman, we believe that, under both the Administrative Procedures Act and the Paperwork Reduction Act, your agencies could still do more to provide clarity to the regulated community in this instance. **We therefore urge that, prior to issuing a final rule, your agencies undertake additional efforts to determine, on a state-by-state basis, precisely what transactions payment systems are required to block.**

We thank you for all of your efforts in this matter and for your service to our country. If you have any further questions regarding this issue, please feel free to contact Josh Saltzman, Deputy Chief of Staff for Congressman Pete Sessions, at Josh.Saltzman@mail.house.gov or 202.225.2231.

Sincerely,



Connie Mack

Dean Heller

Joe Barton

Fred Upton

Lynn A. Westmoreland

Marsha Blackburn

David Hobson

Michael T. McCaul

Internet Gambling Regs
Signature Map

Page One

Left Column	**Right Column**
Pete Sessions	Ron Paul
Peter King	John Carter
John Culberson	Jon Porter
Jeff Flake	Jeb Hensarling

Page Two

Connie Mack	Dean Heller
Joe Barton	Fred Upton
Lynn Westmoreland	Marsha Blackburn
Darrell Issa	Mike McCaul

Dear Members of the Financial Services Committee:

We represent a diverse and bipartisan coalition of family and faith-based organizations representing millions of citizens nationwide, who wish to protect families from the dangers of Internet gambling and see the rule of law upheld.

Internet gambling represents the most invasive and addictive form of gambling in history. Speed, accessibility, availability and anonymity make Internet gambling the perfect storm for gambling addiction. Internet gambling lures young people into a gambling lifestyle, particularly college students who are forming poor habits for adulthood by piling large gambling debts on top of their student loans. Compulsive gambling at any age threatens families with a variety of financial, physical, and emotional problems, including suicide, divorce, child neglect, and a range of problems stemming from the severe financial hardship that commonly results from pathological gambling. This is why every state heavily restricts and regulates gambling activities, and no state has broadly authorized Internet gambling.

Nevertheless, for many years gambling was widely available online throughout the United States, despite state and federal laws banning it. These gambling websites were hosted by foreign operators, who deliberately located offshore in order to evade U.S. law enforcement efforts. Headquartered in a handful of countries that have chosen to harbor Internet gambling operations, many of the companies profiteering from activities that are illegal in the U.S. have been impossible to prosecute, enabling them to proliferate and deceive Americans into thinking their online gambling was legal.

In the last Congress, this committee took a leadership role in the effort to enforce gambling laws on the Internet, by drafting and reporting the Unlawful Internet Gambling Enforcement Act of 2006 (UIGEA), which was enacted into law a few months later. We applauded UIGEA's enactment and we are grateful for this committee's hard work - not only in the last Congress, but over several years - that made UIGEA possible. Many Internet gambling companies have withdrawn from the U.S. market. A recent study by the Annenberg Public Policy Center shows that UIGEA has greatly reduced Internet gambling, gambling on card games, and symptoms of problem gambling among college students, to about one-quarter of the 2006 rates.

Still, UIGEA has not yet reached its full potential because the regulations required to implement the payment-blocking portion of the law have not been finalized. In October 2007, the Department of the Treasury and Federal Reserve Board issued proposed regulations. We believe these proposed regulations were a good start and a sincere effort to fulfill the intent of UIGEA. The proposed regulations recognize that most Internet gambling operators use foreign banks to collect payments, and use the contractual relationship between American financial businesses and foreign banks to hold these offshore banks accountable for respecting U.S. laws. They also do not exempt any major

payment system, but carefully target the participant in each type of payment system who is in the best position to block or prevent illegal payments for online gambling.

We do think that the proposed regulations should be strengthened in a few respects. We think there should be more guidance about what types of penalties are appropriate for regulatory violations, and when they should be imposed. The regulations need to be a meaningful deterrent to doing business with illegal Internet gambling companies, but under the current draft, the regulations might not require anything more than a warning or light slap on the wrist. We also think that the identity of violators should be shared with all financial businesses by the regulators, for better monitoring and deterrence.

Though we think the proposed regulations could be improved, we believe they are on the right track and strongly disagree with insinuations that they are unworkable because of a theoretical possibility of blocking some legal transactions with Internet gambling operators. Nearly all Internet gambling is illegal in the United States under state and/or federal laws. It should be the responsibility of Internet gambling operators to prove that their transactions with U.S. customers are legal and authorized. These companies that have hid offshore and defied American law for years are not entitled to any benefit of the doubt.

The biggest problem with the UIGEA regulations is very simple: they have not yet been finalized, implemented, and tested. The agencies should act quickly to finish implementing the law. The regulations should not be held up by theoretical and unproven complaints. It is time to finish implementing UIGEA, not abandon it. Even in advance of regulations, UIGEA has been very effective at reducing Internet gambling and enforcing American gambling laws. The government should keep moving forward with effective regulations that will enforce the law and protect American youth and families from the many harms of Internet gambling.

Sincerely,

Tom McClusky
Vice President of Government Affairs
Family Research Council

Tom Minnery
Senior Vice President of Government
and Public Policy
Focus on the Family

Carl Herbster
AdvanceUSA

Maureen Wiebe, Legislative Director
American Association
of Christian Schools

Jim Backlin, VP of Legislative Affairs
Christian Coalition

Phil Burress, President
Citizens for Community Values

Wendy Wright, President
Concerned Women for America

Karen Testerman, Executive Director
Cornerstone Policy Research

Phyllis Schlafly, President & Founder
Eagle Forum

John Stemberger,
President & General Counsel
Florida Family Action

David E. Smith, Executive Director
Illinois Family Institute

Maurine Proctor, President
Family Leader Network

Ron Shuping, Executive VP of
Programming
The Inspiration Networks

Robert W. Peters, Esq.

David Crowe, Director
Restore America

Barrett Duke, Ph.D.
Vice President for Public Policy and
Research
Southern Baptist Ethics & Religious
Liberty Commission

C. Preston Noell III, President
Tradition, Family, Property, Inc.

American Bankers Association

Questions for ABA
U.S. House of Representatives
Committee on Financial Services
Contact: Terrie Allison

- **Q. You seem to misunderstand the reason that banks are being asked to block illegal Internet gambling transactions. It isn't difficult for law enforcement to *find* the criminal gambling businesses or their bank accounts. They're advertising on the Internet. They're open and notorious. The problem is that, as long as foreign operators don't travel through the U.S., we can't arrest them and hold a criminal trial. So we're arresting the money instead, which flows through your systems. Do you support the fundamental goal of UIGEA, which is to arrest the international movement of funds for illegal online gambling through your payment systems?**

  A. We do not believe that it is in practice possible for financial institutions to use the payments systems effectively and efficiently to enforce unlawful Internet gambling laws. Requiring banks to do so will do little to prevent payments from being made to the gambling establishments, but such a new mandate will significantly erode the value of the payments systems for their multitude of other important uses by law abiding people and businesses. Businesses, individuals, financial institutions, and even government agencies rely on payments systems that are safe, secure, and efficient. They are designed to facilitate the transfer of funds from one party to another.

  In fact, one of our chief concerns is that the UIGEA and its proposed regulation would take financial institutions beyond the program of reporting suspicious behavior to authorities as required by other regulations governing unusual funds transfers. The UIGEA would require that banks make their own determinations about the legality of the conduct of other parties, and then based on those determinations administer penalties against other parties. It is not wise or appropriate to delegate these governmental powers and responsibilities to financial institutions.

- **Q. What do you believe the U.S. government could do to assist financial institutions in complying with the enhanced due diligence requirements of the proposed regulations?**

  A. The first step is that government agencies need to define with specificity what are unlawful Internet gambling activities. Then U.S. government agencies need to negotiate effective arrangements with foreign governments for mutual and effective cooperation for the enforcement of the standards, since most Internet gambling activity is

reported to involve businesses located outside of the jurisdiction of the United States. These steps would be helpful. Without them, we do not see how the purposes of the legislation can be effectively met.

- **Q. I understand that business entities engaged in offshore unlawful Internet gambling activities in the United States may have credit card merchant accounts that process both lawful and unlawful transactions. Could the "overblocking" problem be solved simply by creating separate merchant accounts, or separate merchant account codes for the activities that are "lawful" and those that are, in the United States at least, unlawful?**

  A. First of all, I do not know of any credit card company that would create a separate merchant account for known "unlawful" activities. With regard to gambling accounts in general, financial institutions must be allowed to apply "overblocking" policies in order to respond to business judgments about risks involved with *known* gambling activities and actors. While this will not solve the problem of gambling enterprises that are not identified—and that would have to include nearly all "unlawful" gambling activities—it will allow banks to respond to the known risks. In fact, the agencies drafting the regulation sought comment on the issue:

  "The Agencies believe that the Act does not provide the Agencies with the authority to require designated payment systems or participants in these systems to process any gambling transactions, including those transactions excluded from the Act's definition of unlawful Internet gambling, if a system or participant decides for business reasons not to process such transactions."[1]

  Some financial institutions have adopted policies that would prohibit their payment systems from processing any gambling transaction, because they consider them high risk transactions, more likely to be challenged or disputed by customers. In order to accommodate such business judgments, we strongly recommend that the final regulation contain a strong safe harbor for any financial institution that that chooses to block transactions that may be related to gambling. This safe harbor takes on increased importance when one considers that there is no definition for what constitutes "unlawful Internet gambling." As part of a comprehensive risk management program, financial institutions may elect to block any gambling related transaction that they can identify due to the ambiguous definition of what may be considered lawful.

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[1] FEDERAL RESERVE SYSTEM,12 CFR Part 233, Regulation GG; Docket No. R-1298, DEPARTMENT OF THE TREASURY, 31 CFR Part 132, RIN 1505-AB78, PROHIBITION ON FUNDING OF UNLAWFUL INTERNET GAMBLING

American Bankers Association

- **Q. In June of 2002, Citibank agreed with the New York State Attorney General's Office to block transactions that are identified by casinos and web sites as online gambling, and other ABA members like Bank of America, Fleet, Direct Merchants Bank, MBNA, and Chase Manhattan Bank have also taken it upon themselves to block such transactions. Yet your testimony indicates that such blocking is impossible. Are you suggesting that your members are incapable of doing what they already agreed to do?**

  A. According to the June 14, 2002, press release issued by then New York State Attorney General Elliot Spitzer, "Under the agreement, Citibank will block (credit card) transactions *that are identified by casinos and web sites* as online gambling."[2]

  This is consistent with our testimony. Financial institutions remain capable of blocking payments to merchants with certain codes, *where the merchant voluntarily cooperates in identifying the transactions*. The press release was silent regarding blocking credit card payments to Internet gambling casinos or websites that did not voluntarily identify themselves. We would note that the businesses in this context would likely deny that the payments that they identify and which are being blocked are illegal. Merchants engaged in businesses that they believe or suspect to be illegal are far less likely to be cooperative.

  This process may result in blocking transactions, but it relies on Internet gambling businesses to act against their own self interest and not camouflage unlawful payments using an acceptable merchant code. It may also lead to Internet gambling businesses to accept payments in other forms.

- **Q. The regulations contain very modest requirements for U.S. financial institutions who do business directly with foreign banks. Essentially, they need to ask their foreign banking partners to promise, through contract, to take reasonable steps to prevent the transmission of restricted transactions through U.S. banks. But you want to eliminate any requirements for cross-border transactions. You also want to exempt everyone except the gambling business's bank from any regulatory obligations. But since almost all illegal gambling businesses are located offshore and use offshore banks, what's left? Wouldn't your proposal make the regulations entirely ineffective and pointless?**

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[2] http://www.oag.state.ny.us/press/2002/jun/jun14a_02.html, emphasis added.

American Bankers Association

A. We believe that the regulations as drafted already would be ineffective in stopping unlawful Internet gambling, first of all because they do not define what is "unlawful". If neither U.S. law enforcement agencies nor U.S. financial institutions know what constitutes "unlawful Internet gambling," how can we expect foreign financial institutions to agree to a commitment to block these transactions? And without that cooperation, given your observation—that we share—that so much of Internet gambling involves offshore businesses, effective enforcement of the Act becomes impossible. We are merely noting the realities of the situation, that we cannot expect foreign banks to do what our own governmental agencies have failed to do. This demonstrates an unresolved structural problem in the Act and the proposed regulations, namely that making financial institutions the enforcement mechanism for an unclear law is a step too far in delegating governmental responsibility.

Moreover, even with a working definition of unlawful Internet gambling, there would be an additional hurdle to overcome. The U.S. Government would be relying on foreign banks, in countries where Internet gambling is legal, to interpret U.S. federal and state law to determine if their commercial customers are running illegal (in the eyes of the United States) Internet gambling businesses, and to help apply sanctions against the activities of their own compatriots, which cooperation may be inconsistent with their own domestic statutes if not cultures, and which would likely make such foreign banks vulnerable to lawsuit from their national businesses..

- **Q. What's so hard about asking foreign contractual partners to promise to respect U.S. laws and engage in some form of "due diligence" or "know your customer" when they do business with U.S. banks? If the final regulations provided you with safe harbor sample language for your contracts, so you wouldn't have to pay your lawyers to draft language, would you have any objection to the requirement?**

A. The main challenge is not hiring legal talent. The main challenge is that over several decades' strong resistance has developed abroad, often reinforced by foreign laws, to the extraterritorial enforcement of U.S. statutes. This is even more difficult when foreign cultures, practices, and statutes conflict with both the letter and purpose of the U.S. laws. This is particularly true for the extraterritorial application of U.S. gambling statutes. This is further compounded when the very terms of application and interpretation of the U.S. gambling laws are in doubt, even by U.S. law enforcement agencies. All of these weaknesses cripple any effort to obtain international cooperation to enforce the UIGEA.

American Bankers Association

- **Q. You mention the problem of a foreign bank being expressly prohibited by their country's law from having policies to identify transactions that would be unlawful in the United States. Specifically, what countries currently prohibit financial institutions operating in their borders from contractually providing information about these transactions to other institutions with which they have a correspondent relationship?**

  A. Most developed nations have strong laws protecting the privacy of the banking information of customers. That is the standard rule. Few exceptions are made to that rule, and these only where the nation shares with us an underlying consensus in the purpose for making that exception, such as specific anti-terrorism efforts. We are not aware of major European nations that share with the United States a consensus on Internet gambling transactions.

  As just one example, the British Bankers Association filed a comment letter[3] with the Federal Reserve regarding the proposed regulation, in which they made the following point:

  > 10. Members also point out that blocking or freezing transactions could very well open them to claims of civil liability by the customer if such actions are taken in a non-US legal jurisdiction to comply with US Regulations. Similarly, a US bank operating in a non-US country could be sued in that jurisdiction's courts for failing to honour a payment without legal justification under the appropriate national law. The problem would be particularly acute if the action were taken on the basis of reasonable belief, given the uncertainties over definitions which, under the terms of the draft Regulation, the Federal Reserve System and the Department of Justice take no responsibility for resolving.

- **Q. You say that a law enforcement provided list of illegal Internet gambling businesses would overcome many of the concerns you have about the difficulties with identifying illegal transactions. Can you briefly explain, for our benefit, how your member institutions already utilize similar lists to stop illegal or dangerous financial transactions?**

  A. The Office of Foreign Assets Control (OFAC) of the U.S. Department of the Treasury administers and enforces economic and trade sanctions against targeted foreign countries, terrorism sponsoring organizations and international narcotics traffickers identified by the U.S. Government. OFAC administers a database containing names that financial institutions and other U.S. companies are required to match against their own customer database as well as new business prospects. The list also contains entire countries and organizations that *all U.S. companies* must avoid when conducting business.

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[3] http://www.federalreserve.gov/SECRS/2007/December/20071213/R-1298/R-1298_119_1.pdf

American Bankers Association

An effort to use the OFAC model to combat illegal Internet gambling activity would require a sanctions regime in line with others under the OFAC umbrella, enlisting the full scope of service providers. Internet Service Providers (ISPs), software vendors, hardware manufacturers, web-hosting companies and search engines would all be obligated to cease doing business with the offending listed illegal Internet gambling enterprises.
Banks are only one of many actors in the commerce chain that are covered by OFAC type sanctions. Today, our bank members share the OFAC burden with all U.S. businesses as well as all U.S. citizens to make sanctions more effective. Banks, technology providers, and each and every U.S. citizen would be required to participate in the effort.

Moreover, it is important to note that under the OFAC regime, it is a government agency that is identifying the bad actor and that is directing the application of penalties. UIGEA as currently drafted would unwisely shift both of these governmental duties to the banking industry.

- **Q. You say you need at least 24 months to implement these regulations. Why? What do you need to do that can't be done in 6 months?**

  A. Even 24 months would be too short a time if the major weaknesses in the program that we have identified in our testimony are not resolved. Assuming that they can be and are resolved, it still takes time to create the appropriate systems, renegotiate contracts, and obtain cooperation from foreign governments

  Financial institutions would have to coordinate efforts with the card networks on blocking unlawful transactions. All new account applications would have to reviewed and revised to assist in identifying potential new accounts associated with illegal Internet gambling. If the financial institution acts as the acquiring bank for merchants accepting credit cards for payment, it would need to develop and implement a process for reviewing that customer's business activities at the account opening and on an ongoing basis. Finally, all staff training would need to be reviewed and revised to reflect these changes.

  The activities listed above are very broad, and they do not include the smaller but essential details of work that each category would require. The drain on financial institution resources would be substantial.

BITS

FINANCIAL SERVICES
ROUNDTABLE

May 8, 2008

Mr. Thomas Duncan
General Counsel
Committee on Financial Services
US House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

Dear Mr. Duncan,

On April 17th you sent a letter requesting answers to five questions regarding my April 2nd testimony before the Subcommittee on Domestic and International Monetary Policy, Trade, and Technology's hearing on "Proposed UIGEA Regulations: Burden Without Benefit?" Enclosed are answers to these questions in addition to minor edits to the draft transcript.

Please let me know if you have any questions.

Sincerely,

Leigh Williams
BITS President

Enclosures

Response to Questions on Illegal Internet Gambling Hearing

Q1: Is there any reason that you could not block all transactions to an Internet gambling business that engages in some transactions that clearly violate U.S. gambling laws, such as online sports gambling, even if some other transactions would be legal? [If answer to that they might be held liable for over blocking: How would you like to see the safe harbor clarified to make sure that you can block all transactions for businesses that sometimes violate the law?]

A1: Given the difficulty in defining what is unlawful, any policies and procedures developed by designated payment systems participants could prevent many lawful transactions. Consequently, it is critical that designated payment systems participants be protected against third party actions from legitimate businesses that are blocked pursuant to the policies and procedures adopted by those participants to meet their obligations under the Act and regulation. Thus, our financial institution members support the "over blocking" provision in the Proposed Regulation. This would allow designated payment systems participants to develop and implement policies and procedures that are flexible and workable so long as they are "reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions," even if it sometimes results in the prevention of legal transactions.

Q2: You state that one alternative is to exempt ACH, check and wire transfer systems entirely. Is it not predicable, if this blanket exemption were granted, that all the illegal funds would simply be routed through the exempted systems, rendering the law impotent?

A2: Not necessarily. Financial institutions already devote substantial resources to knowing their customers and identifying suspicious transactions for payments functions including ACH, check and wire transfer systems. Individual firms may have hundreds of people dedicated to anti-money laundering programs, OFAC blocking, and Suspicious Activity Reporting. We recommend that the Agencies clarify in the final rule that the regulations do not create an additional monitoring requirement for entities that are subject to anti-money laundering monitoring and reporting obligations, and that participants in designated payment systems be deemed to have satisfied their monitoring obligations under the regulations if they comply with their existing policies and procedures with respect to their anti-money laundering, anti-terrorist financing, OFAC-compliance, and suspicious-activity reporting obligations.

Q3: You recommend that the regulation should not create "an additional monitoring requirement for entities that are subject to anti-money laundering monitoring and reporting obligations," and that compliance with existing policies and procedures for anti-money laundering, anti-terrorist financing, OFAC compliance and suspicious activity reporting obligations should be deemed to be in compliance with UIGEA. Could you briefly explain what your current monitoring obligations are under these other requirements, and how they might encompass illegal Internet gambling transactions?

A3: The Bank Secrecy Act requires financial institutions to file reports on suspicious activities (SARs) as well and to implement anti-money laundering compliance programs. Following the 9/11 terrorist attacks, key provisions of the BSA were revised by the USA

PATRIOT Act to criminalize the financing of terrorism, strengthen customer identification procedures, prohibit financial institutions from engaging in business with foreign shell banks, and require financial institutions to have effective due diligence procedures, among other requirements. The USA PATRIOT Act also extended the anti-money laundering compliance program requirements to all financial institutions, including securities firms and insurance companies. Additionally, OFAC regulations prohibit financial institutions from providing services or processing transactions in which identified parties have an interest. These prohibitions have been used to sever terrorists and their supporters and international narcotics traffickers from economic resources.

Essentially, financial institutions are required to know their customers in order to determine if the customer is conducting illegal activity associated with certain types of activities including money laundering and terrorism financing. What is most vexing about the proposed rule implementing UIGEA is that financial institutions would have to detect illegal gambling transactions without knowing whether the activity is legal or illegal. Businesses that engage in unlawful Internet gambling transactions also will likely engage in lawful transactions that are not prohibited by the proposed regulations and for which there is no reliable safe harbor. The Agencies' decision not to fully define unlawful Internet gambling (based on the underlying UIGEA) places financial institutions in a very difficult position. They cannot know if a transaction is restricted unless they have in hand specifics of the transaction that in almost all instances they will not have.

Our member financial institutions are very concerned that even with final adoption of our recommendations, the rule could impose significant compliance burdens on financial institutions by increasing their role in policing illegal activities, determining whether a transaction is illegal, or by imposing ambiguous compliance requirements that could be subject to wide variations in interpretation by regulators and law enforcement agencies. We believe these functions are more appropriate for law enforcement agencies.

The Agencies should also clarify whether financial institutions have liability on restricted transactions. Given the way the proposed rule is written, financial institutions face a fundamental challenge of balancing lawful transactions including lawful intrastate and interstate gambling transactions versus illegal transactions. This is particularly of concern because of the lack of current codes to differentiate types of payments and technological means for transmitting payments. As a result, we recommend that the Agencies take a closer look at these provisions of the proposed rule and clarify a financial institution's duty both for new or existing customers and for intrastate and interstate transactions. We also urge the Agencies to look at liability issues associated with processing restricted transactions that financial institutions are not aware are restricted. If a financial institution has put into place requisite polices and procedures, but is misinformed by its correspondent banks as to the nature of the transaction of the business involved, that financial institutions should not be held liable.

Q4: Could you clarify your position on using credit cards issued on home equity credit lines for Internet gambling transactions? This is an interesting, unique – and troubling – issue you raise, but I'm not sure I understand what you're proposing.

A4: The use of the Internet raises challenges in that data is transmitted across state and international lines. Further, payments providers do not have policies and procedures to identify and thus prevent restricted transactions. We believe merchants, not financial institutions, are in a much better position to identify an illegal gambling payment and monitor it. The Roundtable recommends that the Agencies look at the issue of using credit cards issued on home equity credit lines to do Internet gambling transactions. This issue is not identified in the proposed rule. Additionally, under the Truth in Lending Act ("TILA") and Regulation Z, creditors are only permitted to prohibit advances on home equity credit lines for reasons specified in TILA and Reg Z. There is no exception in Reg Z or TILA for blocking a gambling transaction on a home equity credit line. As a result, financial institutions receive complaints on claims from customers who do not think these transactions should have been blocked as well as claims that the financial institutions should have blocked the transactions when there are losses based on some illegality theory. Thus, in addition to resolving the potential conflict with TILA, the Agencies must create a safe harbor on this credit card use.

Q5: Setting aside the reasons that the agencies would prefer not to be responsible for setting up a list of illegal online gambling operators, do you think such a list would simplify and strengthen compliance for ACH, check and wire transfer systems?

A5: Overall, the Proposed Rule does not provide adequate detail on the policies and procedures financial institutions must have in place to comply. Financial institutions need to know if a transaction is restricted by knowing many details of the transaction including the location of where the transaction is initiated and legality of the transaction. There are numerous examples of how this could play out given the location of an individual placing a bet, eligibility of the individual making the bet, the location of the entity processing the bet, and the location of the technology that may process the bet.

As a public policy matter, we question whether the cost of maintaining a list is the best or most appropriate use of public or private resources. However, we believe the Government is far better suited to maintain such a list since it can serve as the central database for all financial institutions to use. If such a list were maintained, arguably, it should include domestic and offshore entities. There is precedent in that the Treasury Department currently maintains lists that financial institutions are required to check under OFAC.

CUNA QUESTIONS ON INTERNET GAMBLING

1) **You indicated in our testimony that the government needs to develop a list of the "bad guys," or a "blacklist," for you to be able to reasonably block illegal gambling transactions. You also said that Chairman Frank's bill could be the vehicle for doing this, but the Frank bill only creates a "white list" of licensed businesses. Don't you still need a blacklist, which is *not* a component of Chairman Frank's bill?**

The Internet Gambling Regulation and Enforcement Act, introduced by Chairman Frank, could be the vehicle to help regulators create a blacklist of unlicensed Internet gambling businesses.

The supplementary information to the proposed regulation implementing the Unlawful Internet Gambling Enforcement Act provides that any government agency creating a blacklist would need to ensure that the businesses on the list were, in fact, engaged in unlawful Internet gambling activities, which would require significant investigation and legal analysis.

Chairman Frank's bill would remove the need to investigate and review these businesses for unlawful activity. Augmented by information from the federal government regarding businesses or individuals involved in illegal gaming activities, regulators could publish a blacklist of unlicensed Internet gambling businesses. Such an approach, in conjunction with exemptions and safe harbor provisions, would help financial institutions comply with requirements to block transactions directed to unlicensed Internet gambling accounts without the need to distinguish between lawful and unlawful transactions to the same business.

2) **Though software for screening checks against the OFAC list is not perfect, can you use the same partially-effective techniques for Internet gambling businesses if you have a list? We can't exempt checks entirely because that will give a green light to law evasion. Would it be sufficient if the regulations reassure you that you would not [be] subject to penalties if you use these same techniques for customers on the gambling list, even if some illegal checks still slip through?**

OFAC regulations are written quite broadly and require financial institutions to block or reject virtually all transactions involving a country, entity or individual appearing on OFAC's "Specially Designated Nationals and Blocked Persons" list. Software for screening transactions against a list, similar to the OFAC list, could help financial institutions identify some "bad actors" and block transactions to or from individuals or businesses on that list regardless of the purpose or intent of the transactions.

However, it is not a total solution. Requiring financial institutions to determine the purpose and legality of each transaction imposes complicated policing activities on them. It is not clear how institutions will be able to identify and block individual transactions that fund illegal gambling activities when there currently is no method in place that would allow them to verify the purpose of each transaction.

3) **What do you believe the U.S. government could do to assist financial institutions in complying with the enhanced due diligence requirements of the proposed regulations?**

The proposed regulation, including the due diligence requirements, presents a number of fundamental issues that make compliance under the Act extremely difficult, if not impossible for financial institutions. We believe Congress should repeal the requirement that financial institutions police these transactions.

4) **Do you use any third party contractors, consultants, investigators or others to provide you with information about potential prohibited transactions in other areas, such as Suspicious Activity Reporting? Do these third parties provide useful information in furtherance of your due diligence requirements in other areas?**

We currently do not use software that would be helpful in this area. We are aware of several vendors offering special "interdiction software" which automate the process of sifting through all of the names on the OFAC list.

There are also software programs that detect unusual payment patterns or deviations from expected payment activity. Although automated monitoring systems provide useful information in helping to detect suspicious activity, there is still a manual component to complying with due diligence requirements.

5) **If law enforcement or the regulatory agencies were to provide a black list that would serve as the primary mechanism for identifying illegal gambling transactions, could you quickly implement blocking transactions with entities on the list within 6 months?**

A black list developed by law enforcement or the regulatory agencies could help identify individuals and businesses engaged in unlawful Internet gambling activities, but would not provide a mechanism to identify unlawful Internet gambling *transactions*. Businesses engaging in unlawful Internet gambling may also engage in lawful business transactions. Therefore, under the current proposal, financial institutions would still need a method to analyze each transaction to determine its purpose. Also, it is unclear how long it would take to develop and adopt proper policies and procedures and review and modify operations to conform to new requirements since such new requirements have yet to be developed.

This written supplemental testimony responds to certain questions advanced by the Domestic & International Monetary Policy, Trade, and Technology Subcommittee of the Committee on Financial Services subsequent to the oral testimony during the hearing entitled *Proposed UIGEA Regulations: Burden without Benefit*, held on April 2, 2008, of Ted Teruo Kitada, senior company counsel to Wells Fargo & Company, regarding the proposed regulations (the "Proposal") jointly issued on October 4, 2007, by the Board of Governors of the Federal Reserve System and the Departmental Offices of the Department of the Treasury (collectively, the "Agencies"), as published under a notice of joint proposed rule making and request for comment in the Federal Register[1] to implement applicable provisions of the Unlawful Internet Gambling Enforcement Act of 2006 (the "Act").[2]

Set forth below are the questions and the responses thereto.

1. Question: *You propose to exempt ACH, check, and wire transfer systems entirely. Is it not predictable, if these blanket exemption were granted, that all the illegal funds would simply be routed through the exempted systems, rendering the law impotent?*

Response: We continue to urge that ACH, check, and wire transfer payment systems should be exempted under the final regulations, to be issued by the Agencies under the Act. For the purpose of responding to this question, let us stipulate that businesses engaged in unlawful Internet gambling transactions will employ the payment system where they are unlikely to be detected by the participants in that payment system. As explained in our letter and as amplified further below, these three designated payment systems do not have the ability to identify apparent restricted transactions by automated means. Given this systemic deficiency, even if these three payment systems are covered by the final regulations as designated payment systems there is no reason to conclude that the participants in such systems will enjoy much success in identifying and blocking apparent restricted transactions. If there is no reason to conclude that the participants in such systems will enjoy much success in identifying and blocking apparent restricted transactions, there is no reasonable basis to conclude that covering such payment systems under the final regulations will result in driving these transactions from such payment systems. Accordingly, just as we find no reason to conclude that including these three payment systems within the definition of "designated payment system" will have any significant effect in driving apparent restricted transactions from these payment systems, we find no reason to conclude that excluding these systems from that definition will have any significant effect on attracting restricted transactions to these systems.

We contend further that one significant, compelling issue is the consequence of not granting such an exemption and subjecting these payment systems to the final

[1] Prohibition on Funding of Unlawful Internet Gambling, 72 Fed.Reg. 56680 (proposed October 4, 2007), to be codified at 12 C.F.R. Part 233 and 31 C.F.R. Part 132.
[2] Pub.L.No. 109-347, 120 Stat. 1884 (codified at 31 U.S.C. §§ 5361-5367). The Act was signed into law on October 13, 2006.

regulations. The burden is too great, for the apparent benefits to be reaped. Not only would financial transaction providers confront substantial burdens in identifying and blocking apparent restricted transactions, the speed, efficiency, and low cost associated currently with these payment systems could be significantly undermined. This adverse impact would not only directly impact the U.S. payment system, but would also impact the international payment system, encumbering and impairing the national and international payment systems.

- **ACH System.** Originating depository financial institutions ("ODFI") are required under the Proposal to identify and block apparent restricted ACH debit transactions. Receiving depository financial institutions ("RDFI") are required to identify and block apparent restricted ACH credit transactions. Given the limited available fields and the limited number of characters includible in such fields in the ACH record transmitting information regarding ACH entries, financial institutions would confront great difficulty in identifying and blocking apparent restricted transactions by automated means. Consequently, short of reviewing ACH transactions manually to engage in due diligence relative to the underlying genesis of the ACH entry, for the purpose of identifying apparent restricted transactions, ODFIs and RDFIs would not be able to so identify. Subjecting ODFIs and RDFIs to the final regulations would present a substantial compliance challenge, particularly in light of the volume of these transactions originated or received in the payment system daily. For example, as is noted in our testimony of April 2, 2008, we daily originate approximately 3.1 million ACH debit transactions[3] and we daily receive approximately 1.2 million ACH credit transactions. Further, this compliance challenge is compounded by the ambiguity surrounding the meaning of the terms "unlawful Internet gambling." We are asked to apply a complex set of federal and states laws to each transaction, with little or no information regarding the genesis of it. In short, given the volume, operations, and technology of the ACH system, even if that system were covered under the final regulations as a designated payment system, the system is highly unlikely to identify and block apparent restricted transactions.

- **Check System.** In contemporary automated check processing, information from the magnetic ink character recognition ("MICR") line set forth along the bottom of checks is captured by collecting and paying banks to facilitate the collection and payment of checks. The fields of the MICR line have specifically assigned roles in this process, from identifying the paying bank through the routing transit number field, to identifying the drawer's account number through the "on-us" field. Further, only a finite number of numeric characters can occupy each field. (Expanding the fields or introducing new fields can involve changes to systems and equipment used to process checks.) Without relying to some extent on information captured from the MICR line, financial transaction providers have no automated method to identify and block apparent restricted transactions, assuming that the MICR line can even be used for such an ambitious purpose. If a financial

[3] We are the number 3 originator of ACH transactions currently. Bonnie McGeer, *Wells-B of A ACH Venture Spurs Debate,* The American Banker, May 22, 2008, at 11.

transaction provider cannot rely on the MICR line, it must turn to a visual inspection of checks and to conduct specific due diligence relating to the underlying transaction causing the issuance of such checks in order to identify and block apparent restricted transactions. Only a visual inspection of a check will enable an examiner to identify the drawer, payee, and other information from a check. One can well appreciate the adverse impact that a visual inspection process would have on the payment system. We process approximately 11 million checks daily, with approximately six million of such check payable by, at, or through third party financial institutions. A visual inspection of even a small population of checks processed for collection domestically could add significant costs and delays to the check collection and payment system. As shown by the above, we anticipate that including the check system as a designated payment system will highly unlikely advance the purpose of the Act of precluding apparent restricted transactions from utilizing this system. Additionally, under the Proposal, when we act as a depository bank to a foreign correspondent bank, we are obligated to include a term in an agreement that the foreign correspondent bank must have policies and procedures to identify and block apparent restricted transactions. In that regard, we arguably may have some responsibility to monitor the foreign correspondent bank's transactions to assure compliance with such agreement. Thus, adding checks processed for collection from international sources would add to this significant burden.

- **Wire Transfer System.** As a beneficiary's bank, we would have an obligation under the Proposal to identify and block apparent restricted transactions. While the beneficiary's bank may currently receive certain, limited information about the wire transfer transaction, including the name and address of the originator, the name of the intended beneficiary, the amount and date of the wire transfer, and the account number of the beneficiary to which the wire transfer's proceeds are to be credited, wire transfer transactions are processed generally by automated means by the beneficiary's bank, relying solely on the account number associated with the account intended to be credited with the proceeds of the wire transfer. In order for a beneficiary's bank to identify and block apparent restricted transactions, that bank must undertake due diligence as to the underlying wire transfer transaction, reviewing, *inter alia*, information about the wire transfer available from the transaction record and contacting the originator's bank for further information, if necessary. Again, such review and contact would significantly impair the wire transfer system. We receive daily approximately 25,000 to 30,000 incoming wire transfers in our role as beneficiary's bank. A visual inspection of even a small population of such incoming wire transfer transactions could saddle the wire transfer system with significant costs and delays. Given this volume and the state of the technology in this payment system, we are skeptical that including the wire transfer system as a designated payment system under the final regulations will further the goals of the Act. Further, under the Proposal as an originator's bank or intermediary bank sending a wire transfer directly to a foreign bank, we would have the responsibility to deny access to such bank as to restricted transactions. As an originator's bank, we receive payment

orders through a number of portals, including over-the-counter at office locations; by facsimile; by email; telephonically; and electronically, through computer-generated orders prepared at customer locations. We would be required to undertake due diligence as to these wire transfer transactions originating through such multiple portals. We originate approximately 5,000 to 6,000 wire transfers to foreign banks daily. Further, as an intermediary bank in a foreign wire transfer transaction, we would have even more limited information, having no direct contact or relationship with the originator. Identifying and blocking apparent restricted transactions will have material adverse consequences. Costs in handling routine wire transfer transactions will dramatically escalate as this due diligence process is established. Originators will also experience numerous delays as the due diligence process unfolds. The international financial community will suffer the ripple effects of these additional requirements.

2. Question: *You stated that, in lieu of an exemption for ACH, check, and wire transfer payment systems, the Agencies could create a government-generated list. Please explain how such a list would enable you to block illegal Internet gambling transactions. And in structuring such a list, what are the essential elements to make it workable for you while still carrying out the purpose of the law?*

Response: We urge that the Agencies provide a list of those businesses engaged in unlawful Internet gambling activities. The Act fails to provide a definition for the term "unlawful Internet gambling," causing us to rely instead on federal or state law to define such term. While having a government-generated list will not enable us directly to identify and block restricted transactions, the list will assist in fostering the goals of the Act, by enabling us to identify customers the government has identified as originators of restricted transactions. If such a list were available to us, we could employ the list in a number of ways to identify and block apparent restricted transactions. However, as shown below, the most significant benefit of that list would be in connection with the establishment of new account relationships, not as to existing accounts as of the effective date of the final regulations.

- **Card System.** In the card payment system, a merchant acquirer could elect not to be an acquirer for a merchant business on the government-generated list, upon confirming that a merchant applicant is indeed on the list. In that regard, a taxpayer identification number associated with businesses on the government-generated list would be extremely helpful in properly identifying the applicant. While some business account applicants could have both lawful and unlawful operations, our practice would probably reflect a cautious, over-inclusive approach, declining to establish a merchant relationship with a business with any unlawful line of business. Similarly to our current practice of scrubbing prospective account applicants against the list issued by the Office of Foreign Assets Control ("OFAC"), we would review that business applicant against that government-generated list. As to existing merchants, the process of identifying merchants on the list may be considerably more burdensome, subject to the manner in which the list is compiled. If the list included taxpayer identification

numbers, scrubbing the government-generated list against existing merchants may involve less of a burden for us:[4] the merchant acquirer could identify those merchants on the list by automated means and the merchant acquirer could elect to end the banking relationship with that merchant, upon confirming that an existing merchant is on the list.[5] However, if a taxpayer identification number is not provided under the list, the merchant acquirer faces a daunting task examining the population of existing business customers and identifying those merchants engaged in the business of unlawful Internet gambling. We have over 1.8 million business deposit account relationships, for example. One can well appreciate our difficult task attempting to identify those merchants engaged in unlawful Internet gambling when we do not have a taxpayer identification number. This task will be further compounded because we anticipate that the government-generated list will be updated from time to time, causing us to review our existing customer base regularly upon such updating. Because a payee of a card must generally have a merchant acquirer, as new merchant business customers, merchants on the list would in effect be excluded from the card payment system. However, as to existing merchant business customers, until identified by us they may continue to enjoy participating in the card payment system.

- **ACH System.** As noted above, ODFIs are required under the Proposal to identify and block apparent restricted ACH debit transactions. RDFIs are required to identify and block apparent restricted ACH credit transactions. Because ACH transactions require deposit accounts to effect debit and credit transactions, as to new deposit accounts, a financial transaction provider could elect not to open a new deposit account for a merchant business on the government-generated list, upon confirming that a merchant applicant is indeed on the list. However, as to existing business customers, we again confront difficulty as detailed above in the event the government-generated list does not include a taxpayer identification number for the customer.

- **Check System.** Similarly to ACH transactions, the check payment system normally requires a deposit account to effect collection and payment. (While we could collect a check for a payee, normally that payee has a deposit account relationship with us.) If we were provided a government-generated list of those businesses engaged in unlawful Internet gambling transactions, as to new deposit account applicants, we could scrub that applicant against the list. We could simply summarily refuse to open new deposit accounts for those businesses on the list, provided we were satisfied that the applicant is indeed on the list. Again,

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[4] While having the taxpayer identification number may assist in identifying a business on the government-generated list, not all businesses would be identified, as we may not have a taxpayer identification number for all of our business customers, generally only those customers where the account relationship was established on or after October 1, 2003, the effective date of the final regulations issued under the USA PATRIOT Act § 326. 68 Fed.Reg. 25090.

[5] We are not sanguine that such a government-generated list would include taxpayer identification numbers of the businesses engaged in unlawful Internet gambling activities. We suspect that such a list would be similar to the list currently generated by OFAC. The specially designated nationals on the list, for example, currently do not include taxpayer identification numbers.

however, we face a formidable task in identifying and ending the banking relationship with existing business customers if that list does not include a taxpayer identification number for the business.

- **Wire Transfer System.** The wire transfer system requires a deposit account for us to act as a beneficiary's bank. However, we could originate a wire transfer to a foreign bank on behalf of an originator without a deposit account relationship, albeit most originators are deposit account customers. If we were provided a government-generated list of those businesses engaged in unlawful Internet gambling transactions, as to new deposit account applicants and wire transfer originator's with and without a deposit account relationship, we could scrub that applicant or originator against the list. We could simply refuse to open a new deposit account or originate a wire transfer for those businesses on the list, provided we were satisfied that the applicant or originator is indeed on the list. Again, however, we face a formidable task in identifying and ending the banking relationship with existing business customers if that list does not include a taxpayer identification number for the business.

3. Question: *Even if there is some doubt about whether certain gambling activities are legal, couldn't you or your foreign correspondent bank block any commercial customer who engages in activities with U.S. customers that are clearly illegal, such as online sports gambling?*

Response: While we have not inventoried all the state and federal laws involving this subject, we are not aware of any "clearly" unlawful Internet gambling activities. As Louise L. Roseman, Director, Division of Reserve Bank Operations and Payment Systems, Board of Governors of the Federal Reserve System, testified on April 2, before this Committee, there is nothing definitive about this term:

> The Act does not spell out which gambling activities are lawful and which are unlawful, but rather relies on underlying Federal and State laws. The Act, does, however, exclude certain intrastate and intratribal wagers from the definition of "unlawful Internet gambling," and excludes any activity that is allowed under the Interstate Horseracing Act of 1978. The activities that are permissible under the various Federal and State gambling laws are not well-settled and can be subject to varying interpretations.[6] (Emphasis supplied.)

Given this observation, we risk blocking even "clearly" unlawful Internet gambling activities at our peril. The transaction may be an excluded transaction, for example. If the transaction were deemed excluded under the Act, we would lack the statutory predicate under the Act to block the transaction.

Even the Agencies note in the Proposal that unlawful Internet gambling activities are difficult to identify. For example, while exploring the possibility of creating a

[6] Testimony of Louise L. Roseman, Director, Division of Reserve Bank Operations and Payment Systems, Board of Governors of the Federal Reserve System, testified on April 2, before this Committee, at page 1.

government-generated list of businesses engaged in unlawful Internet gambling the Agencies observed the following:

> Any government agency compiling and providing public access to such a list would need to ensure that the particular business was, in fact, engaged in activities deemed to be unlawful Internet gambling under the Act. This would require significant investigation and legal analysis. Such analysis could be complicated by the fact that the legality of a particular Internet gambling transaction might change depending on the location of the gambler at the time the transaction was initiated, and the location where the bet or wager was received.

Accordingly, even if we by agreement require our foreign correspondent banks to identify and block restricted transactions, the location of the gambler originating the transaction may determine whether that transaction is unlawful. The originator may not physically be located in the nation associated with the foreign correspondent bank. Further, even the age of the originator of the transaction may have impact on whether the transaction is lawful or unlawful.

In summary, given the difficulty in determining what is or is not a restricted transaction and given that this question suggests blocking commercial customers engaging in such transactions, as opposed to blocking certain specific transactions, we suggest that the approach proposed by the question is really only workable if the government provides the industry with a list of names of persons engaging in such transactions. In that regard, we refer the reader back to our analysis under question number two above.

4. Question: *Your attached comments suggest that merchant or transaction codes for credit card transactions cannot distinguish legal from illegal transactions. But why should we be concerned about sheltering companies that violate the law, even if they don't violate the law all the time? And couldn't the problem of "overblocking" be solved simply by creating separate merchant accounts, or separate merchant account codes for the activities that are "lawful" in the U.S. and those that are unlawful here but may be lawful and processed with customers outside the U.S.?*

Response: As a preliminary matter, let us stress that our comments are not generated out of a concern "...about sheltering companies that violate the law, even if they don't violate the law all the time." Our concern is generated out of the burdens that we plainly see flowing from the substantial compliance requirements arising from the Proposal. Let us also remind the proponent of the question that it is the Act itself that is focused on transactions, rather than customers. As to the subject of "overblocking," the Act mandates that the final regulations ensure that otherwise lawful activities falling outside the definition of unlawful Internet gambling are not blocked or otherwise prevented or prohibited by the regulations promulgated under the Act.[7]

Further, this question presumes that we may through the simple use of merchant category codes and electronic commerce indicators distinguish between lawful and unlawful

[7] 31 U.S.C. § 5364(b)(4).

Internet gambling activities. As noted above and as highlighted in our comment letter, the distinction between lawful and unlawful Internet gambling activities is not easily drawn. The lawfulness or unlawfulness of an Internet gambling transaction may turn on a number of variables, such as the location and age of the gambler. These variables may not be transparent to the participant in the designated payment system. Indeed, the transaction at issue may enjoy an exclusion. Further, the reliability and integrity of merchant and transactions codes are only as sound as the underlying programs used to develop these codes. The programmers developing these codes face the same difficulty in identifying the merchants and the transactions constituting unlawful Internet gambling as the payment system participants.

○

Louise Roseman subsequently submitted the following in response to written questions received from Congressman Gregory Meeks in connection with the April 2, 2008, hearing on "Proposed UIGEA Regulations: Burden Without Benefit?":

Considering the extremely daunting task of promulgating an effective rule in the near future, what is your response to my colleague's suggestions that an interim sports-only rule should be put in place while either Congress or an Administrative Procedure sort out what types of non-sports wagering are permissible under the UIGEA?

We will consider all comments and options in developing the final rule. We will also continue to consult with the Department of Justice regarding the development of the final rule.

I understand that the proposed regulations make no provision for the creation or sharing of a government supplied or supported list. If law enforcement or regulatory bodies obtain information indicating that restricted transactions are in fact taking place, what mechanisms are there in place under the proposed regulations to permit or facilitate the sharing of this information? How can institutions act in good faith to block transactions that the government suspects are prohibited if there is no mechanism for the government to provide this information to the institutions?

Several mechanisms currently exist for law enforcement authorities to inform financial institutions of risks that may affect their operations. Law enforcement representatives can contact financial institutions directly or through indirect channels, such as financial institution supervisors or the Treasury Department. For example, Treasury's Financial Crimes Enforcement Network (FinCEN) has established a secure system that enables law enforcement agencies, through FinCEN, to make requests under section 314(a) of the USA PATRIOT Act regarding financial institution customers. The context of specific law enforcement information requests can provide assistance to financial institutions in making risk assessments of their customers. In addition, banking and securities supervisors typically have channels in place for conveying information to institutions they supervise.

It seems to be that your main reason for not setting up a "blacklist" of illegal Internet gambling operators is that you do not want to make the effort to research and interpret underlying State and Federal gambling laws, or to investigate violations. But I don't think identifying these criminal enterprises is as hard as the proposed regulations imply. You do not need to establish that every transaction is illegal, only that the operator engages in some transactions that violate Federal or State gambling laws. Couldn't you start with the easy cases? Find gambling sites that take sports bets online – that is illegal everywhere in the U.S. Find sites that take bets from minors. Find gambling sites that are taking bets from residents of Utah or Hawaii, where all gambling is illegal. Couldn't you pretty easily establish a list of the biggest violators, who aren't even trying to comply with U.S. law, that way?

The Act requires that payment system participants prevent or prohibit individual transactions that are for an unlawful gambling purpose under applicable Federal or State law, rather than focusing on *any* transactions that are to or from a particular Internet gambling

company. Further, the Act specifically prohibits the agencies from promulgating regulations that require over-blocking of transactions excluded from the Act's definition of unlawful Internet gambling. We requested comment on the establishment of a blacklist of illegal Internet gambling operators, and we continue to carefully review and evaluate the comments received.

Isn't it quite easy to find illegal Internet gambling sites? After all, they advertise openly on the Internet to attract customers, unlike many other types of illegal activity. So wouldn't it take fairly minimal investigative effort to find these sites, send money to them, and find out how they route the money?

Even if Internet gambling companies could get around a blacklist by changing names and account numbers, doesn't this substantially raise the cost of doing business, and prevent criminal operators from establishing a brand name and luring in large numbers of American customers?

In explaining why the proposed rule does not include a list of unlawful Internet gambling businesses as a procedure for implementing the Act, the rule's preamble stated that, among other reasons, to the extent Internet gambling businesses can change the names they are to receive payments under with relative ease and speed, such a list may be quickly outdated. The preamble requested comments on the creation of such a list, including comments on the practical and operational aspects of creating, maintaining, and updating such a list.

The comments received in response to the proposed rule indicate that, for some Internet gambling businesses, their advertised "brand name" does differ from the payee name reflected in the gambling payments sent to those businesses. The payee name reflected in the payments may be subject to frequent change, at relatively low cost to the gambling business, in the case of non-account based payments made through money transmitting businesses. In the many countries where Internet gambling is not outlawed, foreign authorities may not wish to assist U.S. authorities in preventing payments to Internet gambling businesses in their jurisdictions.

We will carefully consider all comments received regarding the establishment of a blacklist of illegal Internet gambling operators.

I understand your hesitancy about interpreting gambling laws in 50 States. But have you talked with State Attorneys General about how you could work collaboratively with State law enforcement to understand what is prohibited in each State, and to integrate that into a regulatory system that upholds State gambling laws? [If not, why not? If so, what did you learn, and what are you planning to do to reflect that in the regulations?]

The agencies are engaged in further research on these issues, including conference calls with various parties, such as State gambling regulatory agencies and law enforcement. The agencies have not yet spoken with the National Association of Attorneys General, but such a call is anticipated.

You (Ms. Roseman) say that it will be particularly hard for U.S. correspondent banks to develop workable procedures or agreements with foreign banks to block restricted transactions. But the main point of UIGEA is to block cross-border gambling transactions, so you must find a good way to deal with these. Isn't a blacklist the easiest way to stop the

restricted transactions without disturbing other international transactions, at least for ACH, check and wire transfer? Even if a blacklist might not catch every restricted transaction, what are the prospects for any more efficient methods?

The preamble to the proposed rule discussed the difficulty financial institutions have in identifying the purpose of transactions, particularly in the cross-border context. We asked for comments on the proposed rule's approach for cross-border arrangements, and specifically whether alternative approaches would increase effectiveness with the same or less burden. Some comments have suggested alternative approaches and we will carefully consider those comments.

You have indicated that you thought it was not practical for ACH, wire transfer and check system participants to block restricted transactions, except for the entities who either have a direct relationship with the Internet gambling site, or in the case of international payment systems, the U.S. entity that has the direct relationship with the foreign financial institution, so the regulations exempt everyone else in these systems. However, in other areas of cross-border flows of monetary instruments, such as currency transaction reporting requirements, Bank Secrecy Act violations, anti-money laundering efforts, and terrorist financing efforts, there are no similar exemptions. Why is an exemption required for the UIGEA regulations but not for these other types of prohibited transactions? [If you had a blacklist for these systems, would that eliminate the need for these exemptions?]

The Act requires that the regulation exempt designated payment systems or restricted transactions if the agencies jointly determine that it is not reasonably practical for the system or participant to prevent or prohibit restricted transactions, and the preamble to the proposed rule specifically requested comment on the practicality of a blacklist of Internet gambling businesses. Any revisions to the rule's examples of policies and procedures reasonably designed to prevent or prohibit unlawful Internet gambling transactions, such as the incorporation of a blacklist, might also result in changes to the scope of the rule's exemptions.

The proposed rule to implement the Act did make clear that depository institutions have an ongoing responsibility to file suspicious activity reports for illegal transactions, irrespective of any regulations or exemptions thereto that may be promulgated under the Act.

Some financial institutions have complained that their "due diligence" requirements are too vague. Have you considered explicitly requiring gambling businesses to present their banks with evidence that they are licensed by each jurisdiction from which they propose to take bets? Wouldn't that ease the burden for banks and push gambling businesses to make sure they are complying with the law?

Some commenters suggested that, as part of its due diligence at account opening, the payment system participant opening the account should require a gambling business to provide evidence that its operations are licensed by the appropriate State authorities. The agencies are considering whether these suggestions can be incorporated into the rule's examples of policies and procedures that would be considered to be reasonably designed to prevent restricted transactions.

Are you planning to provide model contractual language in your final regulations, to simplify compliance?

If the agencies conclude that the rule's examples of reasonably designed policies and procedures would benefit from model language, the agencies would carefully consider providing such model language.

The regulations require financial institutions to penalize their commercial customers who transmit illegal gambling proceeds – i.e., private penalties – but they don't specify what happens if a financial institution does not follow the regulations and implement reasonable policies and procedures. Can you explain how the federal agencies will enforce the regulations, and what types of penalties they would impose?

The Act subjects designated payment systems and participants to the enforcement authority of the federal functional regulators and to the Federal Trade Commission for entities not otherwise regulated. Not all the agencies in the Act's regulatory enforcement framework carry out their statutory responsibilities in the same manner, and you may wish to obtain the FTC's perspective on this matter. We expect that the federal banking supervisors would incorporate the requirements of the UIGEA regulations in their compliance reviews of supervised institutions. If significant compliance issues were identified, the supervised institution would be subject to a range of supervisory action within the agency's general authority to address unsafe and unsound banking practices and violations of law or regulation. These include examination criticism; informal action directing the institution to address deficiencies; formal, public action requiring remediation; and civil money penalties.

What can we do to start blocking illegal gambling transactions promptly, even if the procedures will need some tweaking as we learn from real life experience?

The Agencies are currently focused on developing a final rule that leverages existing practices to prevent unlawful Internet gambling transactions and provides additional and reasonably practical examples of actions that U.S. payment system participants can take to further impede the flow of restricted transactions through the U.S. payment system. Many payment system participants have already instituted measures to prevent or prohibit transactions related to unlawful Internet gambling.

Louise Roseman subsequently submitted the following in response to the written question received from Congressman Donald Manzullo in connection with the April 2, 2008, hearing on "Proposed UIGEA Regulations: Burden Without Benefit?":

As you may know, I voted for the Unlawful Internet Gambling Enforcement Act, and I support its stated goals. However, it has come to my attention that the Small Business Administration's Office of Advocacy has filed comments expressing concerns about the proposed rule's compliance with the requirements of the Regulatory Flexibility Act (RFA). As the chairman of the House Small Business Committee for six years, it was my responsibility to highlight and ensure compliance with the laws protecting small businesses. The RFA was enacted to require Federal agencies to consider the cost of their regulations on small businesses. Unfortunately, the rush to complete some regulations has resulted in some regulators disregarding the industry impact study mandated by the RFA. I oppose agency actions that disregard the letter and spirit of this law, even when I support the underlying objective of regulations in question.

Ms. Abend and Ms. Roseman, the SBA Office of Advocacy, has said that in order to comply with the RFA, you need to perform a more thorough Initial Regulatory Flexibility Analysis and then put that Analysis out for separate public comments, because the IRFA issued with the initial rule was inadequate. Do you intend to do this, and if not, why not?

In the preamble to the proposed regulations, the Agencies included an Initial Regulatory Flexibility Analysis (IRFA) pursuant to the Regulatory Flexibility Act. The Office of Advocacy of the Small Business Administration and others submitted comments raising issues about the Initial Analysis. While we believe that the agencies have complied with each of the statutory requirements for an IRFA, we will carefully consider all of these comments. As the agencies move closer to the publication of a final rule, the agencies will comply with all of the statutory requirements for a Final Regulatory Flexibility Analysis at that time. If the agencies determine that the next step in the regulatory process is a new proposed rule because the new iteration of the regulation is sufficiently different from the proposed rule, the agencies would publish a new IRFA with that proposal.

Q) Considering the extremely daunting task of promulgating an effective rule in the near future, what is your response to my colleague's suggestions that an interim sports- only rule should be put in place while either Congress or an Administrative Procedure sort out what types of non-sports wagering are permissible under the UIGEA

Answer:

The Unlawful Internet Gambling Enforcement Act of 2006 (the "Act") requires a rulemaking that is designed to interdict the flow of funds between gamblers and unlawful Internet gambling businesses. The Act does not contemplate the action contained in the question.

Q) I understand that the proposed regulations make no provision for the creation or sharing of a government supplied or supported list. If law enforcement or regulatory bodies obtain information indicating that restricted transactions are in fact taking place, what mechanisms are there in place under the proposed regulations to permit or facilitate the sharing of this information? How can institutions act in good faith to block transactions that the government suspects are prohibited if there is no mechanism for the government to provide this information to the institutions?

Answer:

The proposed rule requires regulated entities to establish policies and procedures that are reasonably designed to identify and block or otherwise prevent or prohibit unlawful Internet gambling transactions. Your question is one that was raised during the comment process. We are in the process of carefully considering and analyzing all comments.

Q) It seems to be that your main reason for not setting up a "blacklist" of illegal Internet gambling operators is that you do not want to make the effort to research and interpret underlying State and Federal gambling laws, or to investigate violations. But I don't think identifying these criminal enterprises is as hard as the proposed regulations imply. You do not need to establish that every transaction is illegal, only that the operator engages in some transactions that violate Federal or State gambling laws. Couldn't you start with the easy cases? Find gambling sites that take sports bets online – that is illegal everywhere in the U.S. Find sites that take bets from minors. Find gambling sites that are taking bests from residents of Utah or Hawaii, where all gambling is illegal. Couldn't you pretty easily establish a list of the biggest violators, who aren't even trying to comply with U.S. law, that way?

Answer:

The issue of a list was one for which we specifically solicited and received comments. We are carefully considering and analyzing all comments, and our analysis regarding a list will be reflected in the preamble to the final rule.

Q) Isn't it quite easy to find illegal Internet gambling sites? After all, they advertise openly on the Internet to attract customers, unlike many other types of illegal activity. So wouldn't it take fairly minimal investigative efforts to find these sites, send money to them, and find out how they route money?

Answer:

We received a number of comments based on the issues raised in the preamble to the proposed rule and are carefully considering and analyzing all comments.

Q) Even if Internet gambling companies could get around a blacklist by changing names and account numbers, doesn't this substantially raise the cost of doing business, and prevent criminal operators from establishing a brand name and luring in large numbers of American customers?

Answer:

We received a number of comments based on the issues raised in the preamble to the proposed rule and are carefully considering and analyzing all comments.

Q) I understand your hesitancy about interpreting gambling laws in 50 states. But have you talked with State Attorneys General about how you could work collaboratively with State law enforcement to understand what is prohibited in each State, and to integrate that into a regulatory system that upholds State gambling laws? [If not, why not? If so, what did you learn, and what are you planning to do to reflect that in the regulations?]

Answer:

We have spoken with representatives from State gambling regulatory commissions about their system of regulation, and a summary of that discussion is being placed in the public record. No decisions have been made at this point regarding any aspect of the final rule.

Q) You have indicated that you thought that it was not practical for ACH, wire transfer . . . .Why is an exemption required for UIGEA regulations but not for these other types of prohibited transactions? [If you had a blacklist for these systems, would that eliminate the need for these exemptions]

Answer:

The exemptions in the proposed rule stem from the Act, which requires us to exempt certain restricted transactions or designated payment systems from any requirements imposed under the regulations if we find that it is not reasonably practical to identify and block, or otherwise prevent or prohibit, the acceptance of such transactions. We requested comments on this issue, and we are carefully considering all comments received, including those addressing the exemptions and the list.

Q) Some financial institutions have complained that their "due diligence" requirements are too vague. Have you considered requiring gambling businesses to present their banks with evidence that they are licensed by each jurisdiction from which they propose to take bets? Wouldn't that ease the burden for banks and push gambling businesses to make sure they are complying with the laws?

Answer:

We carefully considered the burden issue in drafting the proposed rule, we received comments on the due diligence examples contained in the proposed rule and we are carefully considering and analyzing those comments.

Q) Are you planning to provide model contractual language in your final regulations, to simplify compliance?

Answer:

We have not made final determinations on what will be in the final rule.

Q) The regulations require financial institutions to penalize their commercial customers who transmit illegal gambling proceeds – i.e., private penalties – but they don't specify what happens if a financial institution does not follow the regulations and implement reasonable policies and procedures. Can you explain what *federal agencies* will enforce the regulations, and what types of penalties they would impose?

Answer:

The Act provides that the Federal functional regulators and the Federal Trade Commission (FTC) have exclusive civil regulatory enforcement authority, with the Justice Department having criminal enforcement authority for the criminal provisions of the Act. The types of penalties the Federal functional regulators and the FTC might impose would depend upon the facts and circumstances, and the question could be more fully answered by those agencies.

Q) What can we do to start blocking illegal gambling transactions promptly, even if the procedures will need some tweaking as we learn from real life experience?

Answer:

Efforts to implement the requirements of the Act are being undertaken with care and thoughtfulness. We would refer you to the Department of Justice regarding their efforts to investigate and prosecute illegal gambling.

Question submitted by Rep. Manzullo
As you may know, I voted for the Unlawful Internet Gambling Enforcement Act, and I support its stated goals. However, it has come to my attention that the Small Business Administration's Office of Advocacy has filed comments expressing concerns about the proposed rule's compliance with the requirements of the Regulatory Flexibility Act (RFA). As the chairman of the House Small Business Committee for six years, it was my responsibility to highlight and ensure compliance with the laws protecting small businesses. The RFA was enacted to require Federal agencies to consider the cost of their regulations on small businesses. Unfortunately, the rush to complete some regulations has resulted in some regulators disregarding the industry impact study mandated by the RFA. I oppose agency actions that disregard the letter and spirit of this law, even when I support the underlying objective of regulations in question.

Ms. Abend, the SBA office of Advocacy, has said that in order to comply with the RFA, you need to perform a more thorough Initial Regulatory Flexibility Analysis and then put that Analysis out for separate public comments, because the IRFA issued with initial rule was inadequate. Do you intend to do this, and if not, why not?

Answer:

We are carefully considering and analyzing all comments, including the comment letter submitted by the Office of Advocacy of the U.S. Small Business Administration. No decisions have been made regarding the final rule; however, we intend to comply with the requirements of the Regulatory Flexibility Act.

Dear Members of the Financial Services Committee:

We represent a diverse and bipartisan coalition of family and faith-based organizations representing millions of citizens nationwide, who wish to protect families from the dangers of Internet gambling and see the rule of law upheld.

Internet gambling represents the most invasive and addictive form of gambling in history. Speed, accessibility, availability and anonymity make Internet gambling the perfect storm for gambling addiction. Internet gambling lures young people into a gambling lifestyle, particularly college students who are forming poor habits for adulthood by piling large gambling debts on top of their student loans. Compulsive gambling at any age threatens families with a variety of financial, physical, and emotional problems, including suicide, divorce, child neglect, and a range of problems stemming from the severe financial hardship that commonly results from pathological gambling. This is why every state heavily restricts and regulates gambling activities, and no state has broadly authorized Internet gambling.

Nevertheless, for many years gambling was widely available online throughout the United States, despite state and federal laws banning it. These gambling websites were hosted by foreign operators, who deliberately located offshore in order to evade U.S. law enforcement efforts. Headquartered in a handful of countries that have chosen to harbor Internet gambling operations, many of the companies profiteering from activities that are illegal in the U.S. have been impossible to prosecute, enabling them to proliferate and deceive Americans into thinking their online gambling was legal.

In the last Congress, this committee took a leadership role in the effort to enforce gambling laws on the Internet, by drafting and reporting the Unlawful Internet Gambling Enforcement Act of 2006 (UIGEA), which was enacted into law a few months later. We applauded UIGEA's enactment and we are grateful for this committee's hard work - not only in the last Congress, but over several years - that made UIGEA possible. Many Internet gambling companies have withdrawn from the U.S. market. A recent study by the Annenberg Public Policy Center shows that UIGEA has greatly reduced Internet gambling, gambling on card games, and symptoms of problem gambling among college students, to about one-quarter of the 2006 rates.

Still, UIGEA has not yet reached its full potential because the regulations required to implement the payment-blocking portion of the law have not been finalized. In October 2007, the Department of the Treasury and Federal Reserve Board issued proposed regulations. We believe these proposed regulations were a good start and a sincere effort to fulfill the intent of UIGEA. The proposed regulations recognize that most Internet gambling operators use foreign banks to collect payments, and use the contractual relationship between American financial businesses and foreign banks to hold these offshore banks accountable for respecting U.S. laws. They also do not exempt any major

payment system, but carefully target the participant in each type of payment system who is in the best position to block or prevent illegal payments for online gambling.

We do think that the proposed regulations should be strengthened in a few respects. We think there should be more guidance about what types of penalties are appropriate for regulatory violations, and when they should be imposed. The regulations need to be a meaningful deterrent to doing business with illegal Internet gambling companies, but under the current draft, the regulations might not require anything more than a warning or light slap on the wrist. We also think that the identity of violators should be shared with all financial businesses by the regulators, for better monitoring and deterrence.

Though we think the proposed regulations could be improved, we believe they are on the right track and strongly disagree with insinuations that they are unworkable because of a theoretical possibility of blocking some legal transactions with Internet gambling operators. Nearly all Internet gambling is illegal in the United States under state and/or federal laws. It should be the responsibility of Internet gambling operators to prove that their transactions with U.S. customers are legal and authorized. These companies that have hid offshore and defied American law for years are not entitled to any benefit of the doubt.

The biggest problem with the UIGEA regulations is very simple: they have not yet been finalized, implemented, and tested. The agencies should act quickly to finish implementing the law. The regulations should not be held up by theoretical and unproven complaints. It is time to finish implementing UIGEA, not abandon it. Even in advance of regulations, UIGEA has been very effective at reducing Internet gambling and enforcing American gambling laws. The government should keep moving forward with effective regulations that will enforce the law and protect American youth and families from the many harms of Internet gambling.

Sincerely,

Tom McClusky
Vice President of Government Affairs
Family Research Council

Tom Minnery
Senior Vice President of Government
and Public Policy
Focus on the Family

Carl Herbster
AdvanceUSA

Maureen Wiebe, Legislative Director
American Association
of Christian Schools

Jim Backlin, VP of Legislative Affairs
Christian Coalition

Phil Burress, President
Citizens for Community Values

Wendy Wright, President
Concerned Women for America

Karen Testerman, Executive Director
Cornerstone Policy Research

Phyllis Schlafly, President & Founder
Eagle Forum

John Stemberger,
President & General Counsel
Florida Family Action

David E. Smith, Executive Director
Illinois Family Institute

Maurine Proctor, President
Family Leader Network

Ron Shuping, Executive VP of
Programming
The Inspiration Networks

Robert W. Peters, Esq.

David Crowe, Director
Restore America

Barrett Duke, Ph.D.
Vice President for Public Policy and
Research
Southern Baptist Ethics & Religious
Liberty Commission

C. Preston Noell III, President
Tradition, Family, Property, Inc.

April 2, 2008

To the House of Representatives Committee on Financial Services:

As representatives of the major professional sports leagues and the National Collegiate Athletic Association, we wish to commend this Committee for its important work in drafting and reporting the Unlawful Internet Gambling Enforcement Act of 2006 (UIGEA). When UIGEA was enacted in October 2006, nearly identical to the bill reported by this Committee, and having passed the House by large bipartisan margins, it immediately sent a long-overdue signal to offshore Internet gambling companies operating illegally in this country that the United States is committed to enforcing existing and longstanding gambling laws on the Internet. Many of the largest Internet gambling companies withdrew their illegal gambling operations from the U.S. market, virtually overnight.

The implementation of UIGEA is not complete, however. The law required the Treasury Department and Federal Reserve Board to jointly issue regulations requiring financial institutions to implement policies and procedures that would identify and block or otherwise prevent financial transactions in connection with unlawful Internet gambling. The statute required these regulations to be issued by July 2007, but proposed regulations were not published until October 2007, and at this time there is no indication when final regulations will be implemented. These regulations are critical to enforcing the law against those defiant offshore operators who continue to conduct illegal online gambling in willful violation of U.S. law.

In support of effectively and efficiently enforcing UIGEA, we submitted comments to the Treasury Department and Federal Reserve Board suggesting ways to improve the proposed regulations without imposing undue burdens on the financial services sector. We include a copy of our official comments, submitted last December, with this letter.

We are also aware that many commenters, many of whom have a vested interest in delaying or defeating altogether the full implementation of UIGEA, have claimed that the law regarding what online gambling activities are illegal versus legal is ambiguous, causing difficulties for financial institutions implementing the regulations. Whether or not this is a legitimate concern for other types of gambling, there is *no* ambiguity when it comes to online sports gambling: it is clearly and indisputably illegal and has been for decades.

Congress has repeatedly affirmed that sports gambling is against national policy and cannot be reconciled with efforts to preserve the integrity of American athletics. Sports gambling threatens the integrity and appearance of integrity for athletic contests. It puts athletes, coaches and other team personnel, as well as game officials, at risk of pressure and threats from gamblers and organized crime to affect the outcome of a game or reveal confidential information. It lures young people into acceptance of a gambling lifestyle and undermines the family-friendly character of athletic events. Legalizing sports gambling does not eliminate these problems, but increases the prevalence of sports gambling by signaling public approval of this

dangerous activity. There should be no difficulty in identifying and blocking financial transactions directed at promoting sports betting, and the Committee should support the prompt implementation of regulations designed to address this unlawful activity.

Thus, we urge the Treasury Department and Federal Reserve Board to promptly finalize and implement the UIGEA regulations, and we ask this Committee to use its oversight over the regulatory process to ensure that its important work in crafting UIGEA is successfully completed.

Sincerely,

Rick Buchanan
Executive VP and General Counsel
National Basketball Association

Elsa Kircher Cole
VP of Legal Affairs and General Counsel
National Collegiate Athletic Association

David Zimmerman
Executive VP and General Counsel
National Hockey League

Tom Ostertag
Senior VP and General Counsel
Major League Baseball

Jeffrey Pash
Executive VP and General Counsel
National Football League

December 12, 2007

Submitted Electronically

Attn: Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th St and Constitution Ave. NW
Washington, DC 20551
Docket Number R-1298

Department of the Treasury
Office of Critical Infrastructure Protection and Compliance Policy
Room 1327, Main Treasury Building
1500 Pennsylvania Ave. NW
Washington, DC 20220
Treas-DO-2007-0015

Re: Prohibition on Funding of Unlawful Internet Gambling

Dear Board of Governors and Department of the Treasury:

The National Football League (NFL), Major League Baseball (MLB), National Basketball Association (NBA), National Hockey League (NHL), and National Collegiate Athletic Association (NCAA), appreciate the opportunity to comment on the Notice of Joint Proposed Rulemaking published in the Federal Register on October 4, 2007, at 72 Fed. Reg. 56680, et seq. ("NPRM") concerning the implementation of the Unlawful Internet Gambling Enforcement Act of 2006 ("UIGEA"). As representatives of major athletic associations that actively supported the enactment of UIGEA, we wish to see the intent of this law fully and effectively implemented through the final regulations.

Sports gambling threatens both the actual integrity of athletic contests and the perception of the fairness of such contests. It places athletes, coaches and other team personnel, as well as officials, at risk of pressure and threats from gamblers and organized crime to affect the outcome of a game or reveal confidential information. It lures young people into acceptance of a gambling lifestyle and undermines the family-friendly character of athletic events. For these reasons, the Professional and Amateur Sports Protection Act of 1992 put a stop to the proliferation of sports gambling under state laws. Soon thereafter, however, sports gambling spread on the Internet, and offshore sportsbooks fostered a widely mistaken belief among Americans that sports gambling is a legal and acceptable form of entertainment.

Though Internet gambling on athletic contests has always been unambiguously illegal under the Wire Act and numerous other federal and state laws, it is often impossible to prosecute the gambling businesses when they are located offshore in jurisdictions that deliberately harbor these operators. Moreover, it has been the consistent position of the United States to focus prosecution of illegal gambling on the operator rather than the individual gambling customer. Faced with these limitations, the Congressionally-created National Gambling Impact Study Commission recommended in 1999 that the most effective means to combat illegal online gambling would be to stop the financial transactions that fuel this black market. Between 1999 and 2006 the particulars of this concept were repeatedly refined, in consultation with financial institutions and the Congressional committees with jurisdiction over financial services, ultimately resulting in the enactment of UIGEA.

The implementing regulations for UIGEA are intended by Congress to perform an essential role in the enforcement of U.S. gambling laws. We believe the NPRM represents a solid foundation upon which effective final regulations can be built, and we appreciate the efforts of your Agencies to adhere strictly to the Congressional intent underlying UIGEA.

We particularly wish to commend the Agencies for not granting system-wide exemptions to any major payment system. The business model of the Internet gambling companies has always been to exploit any loophole in law enforcement to thwart the letter and spirit of American laws. It accordingly is entirely predictable that if any payment system were to be exempted from these regulations, Internet gambling companies would be swift to advise potential customers in the United States how they could send funds through that exempted system as a means of evading the UIGEA.

We further commend the Agencies for consciously addressing the difficulty that arises from the fact that banks serving Internet gambling operators — like the gambling operations themselves — are almost always located offshore, often outside the direct regulatory jurisdiction of the Agencies. The NPRM aims to regulate these banks indirectly, by requiring that the contractual and other business relationships between U.S. institutions and these foreign banks not be used to facilitate activity that is illegal in the U.S. In payment systems where certain participants are exempted and covered participants would often be offshore, it is necessary to regulate the U.S. participant controlling the cross-border transaction to prevent widespread evasion.

It is essential that, for each payment system, there be at least one effective "chokepoint" for restricted transactions, and that the selection of such "chokepoints" take into account the fact that the gambling operators on the receiving end of these transactions typically are banking outside of the U.S. We do not seek regulations that are more burdensome to payment system participants than are necessary, but in crafting minimally-burdensome regulations this is the one principle that is absolutely indispensable.

In furtherance of these principles, we offer the following recommendations through which the Agencies can build a stronger defense against illegal Internet gambling transactions upon the foundation that has been laid in the NPRM:

I. Shift the burden of distinguishing illegal from legal transactions to the gambling business.

Numerous other commentators have noted that, because the definition of "restricted transaction" relies on the interpretation of underlying federal and state laws and the location of the gambler at the time the gambling transaction is initiated, it would be difficult if not impossible for payment system participants to determine whether any given financial transaction is a restricted transaction, even if one party is known to engage in the Internet gambling business. Some of these commenters have raised concerns that this will cause payment system participants to "overblock" any transaction with ties to Internet gambling, even if that particular transaction happens to be legal. We disagree with any suggestion that the possibility of overblocking would justify an exemption from the regulation.

However, we believe the Agencies can illuminate a path for businesses that legitimately wish to avoid overblocking without creating undue burdens for payment system participants. Commercial customers engaged in online gambling business should be explicitly required to demonstrate to their payment service providers that they have taken adequate steps to ensure that they are not accepting bets or wagers from customers in jurisdictions where such bets or wagers are unlawful. In each jurisdiction from which a gambling business accepts bets or wagers, the gambling business should at least be able to cite the law or regulation that authorizes its online gambling activity. Because the conduct of an unauthorized commercial gambling operation is illegal in every state of the Union, a gambling operation that cannot cite its source of authorization can and should be presumed illicit. Conversely, it would be reasonable for a payment service provider to presume that a gambling business that presents authenticated documentation of authorization in each relevant jurisdiction is not engaged in restricted transactions. Even systems that rely on "coding" could avoid overblocking by using a different code for "authenticated" gambling businesses.

Moreover, we recognize that businesses engaged in gambling may also accept payment for other, non-restricted purposes. For instance, an online gambling site may also sell t-shirts and books. To distinguish these types of transactions, it is reasonable to expect the business to set up a separate account for non-gambling transactions, which could be coded differently (in the case of card systems) and allowed to accept funds without requiring authentication of gambling authorization or geographic limits. Again, by encouraging or requiring the gambling business to set up a separate account for non-gambling purposes, the burden of distinguishing legal and illegal transactions is shifted away from the payment system and onto the gambling business, where it rightly belongs.

II. Strengthen guidance for cross-border contractual requirements.

The NPRM instructs a receiving gateway operator that receives ACH debit instructions from a foreign sender to have a term in its agreement with the foreign sender that requires "the foreign sender to have reasonably designed policies and procedures in place to ensure that the relationship will not be used to process restricted transactions." Section 6(b)(2)(i). A similar instruction applies to a depositary bank that receives a check for collection directly from a foreign bank. Section 6(d)(2)(i). The final regulation should be more explicit as

to the precise nature of "reasonably designed policies and procedures" required by cross-border contracts.

Specifically, we believe that "reasonably designed policies and procedures" for a foreign sender ought to be defined as policies and procedures that are substantially similar to the safe harbor requirements for corresponding U.S. payment system participants, as defined in sections 6(b)(1) and 6(d)(1). It would also be advisable to include in the final regulation sample contractual language that would fulfill this safe harbor requirement. This would minimize legal uncertainty, regulatory burden and cost for payment system participants who are expected to include such a term in their contracts.

We also question why a similar contractual requirement is not part of the safe harbor rules for originating gateway operators that receive ACH credit transactions or banks that send wire transfers directly to foreign banks. It seems that, at least in any case where a cross-border contractual relationship already exists, a similar contractual requirement would facilitate effective enforcement at minimal burden to the payment system participant (particularly if sample language is provided by regulation).

III. Strengthen guidance for imposition of penalties.

The NPRM instructs payment system participants to have policies and procedures addressing when fines should be imposed, services denied, or relationships terminated as a penalty against other parties who transmit restricted transactions. There is no guidance as to whether it would be appropriate to impose penalties after one violation or one hundred violations, or how harsh those penalties should be. More detailed guidance would offer the regulated entities greater certainty and provide more uniform enforcement. We are particularly concerned that payment system participants may impose only nominal penalties while claiming compliance with the regulations. At the very least, the final regulation should require that penalties be reasonably designed to deter effectively the transmission of restricted transactions.

IV. Establish a list of known bad actors to facilitate enforcement.

Though the NPRM instructs payment system participants to impose penalties when restricted transactions are discovered, it gives no indication as to *how* restricted transactions might be discovered in ACH, check and wire transfer systems once customers get past the "screening" requirements. Presumably, state and federal law enforcement will be the primary source for detecting restricted transactions that are not prevented by the due diligence process. As the NPRM is presently structured, it appears that, after law enforcement determines that a restricted transaction has taken place and identifies the source of that illegal transaction, only the financial entities that were non-exempted participants in that particular transaction are required to take any action based upon this information. Such catch-as-catch-can enforcement seriously weakens the deterrent effect of the proposed regulations.

We agree with the NPRM that a list of unlawful Internet gambling businesses compiled by the Agencies would not be, by itself, an effective method for implementing UIGEA. However, we note that some payment system participants have explicitly asked for a list that would help them identify restricted transactions. While it is true that the Agencies do not

enforce or interpret gambling laws, state and federal law enforcement officials do perform this function, and the Agencies are charged with enforcing the final regulations under UIGEA. The Agencies can bring these differing enforcement functions into harmony by establishing a mechanism — in particular, an information database accessible to the regulated entities — by which law enforcement officials with authority to enforce gambling laws can efficiently inform *all* regulated payment system participants of the identity of gambling law violators, including payment system participants who fail to take appropriate steps to avoid abetting this criminal activity.

On a related note, it is not clear to us that a payment system participant who is exempted under section 4 would ever be required to block a restricted transaction, even in cases where the participant has *actual knowledge* that it is a restricted transaction. While we understand exempting participants from due diligence and monitoring requirements when they occupy certain positions in the transaction chain that would normally not be able to detect the illegal nature of the transaction, it is possible that such participants may nevertheless in some cases acquire knowledge that the transaction is restricted. For instance, the gambling business's bank may be an affiliate or law enforcement may provide the information (directly or by means of an information sharing list). The final regulations should be revised to clarify that U.S. payment system participants are not exempt from blocking a transaction, regardless of their "place in the chain," if they have actual knowledge that the transaction is a restricted transaction.

V. Consider how to cover non-traditional payment systems.

There are reports that some online casinos use 900 telephone numbers outside of the U.S. to fund accounts for U.S. customers. Under this scheme, the gambler calls a 900 number outside of the U.S., which appears as a charge on the gambler's telephone bill. The foreign business that sets up the 900 number receives payment through the phone company, and then forwards the funds to the bank of the gambling business to fund the gambler's account. In this case, it appears that no participant in a "designated payment system" (as defined in the NPRM) is domestic, so the regulations would not seem to cover this scheme.

We are not aware of the exact mechanics of the "900 number" payment system, but we urge the Agencies to investigate these reports and make sure this scheme is covered in the final regulations. Further, if other uncovered payment systems are brought to the attention of the Agencies, we strongly support your efforts to close these loopholes.

VI. Finalize promptly and reevaluate frequently.

The NPRM asks for comment on whether the final regulations should take effect six months after the joint final rules are published. We note that the implementing regulations for UIGEA are already long overdue according to the statutory mandate. Moreover, because the NPRM focuses on due diligence procedures instead of new blocking technology, we do not see any reason why payment system participants would be unable to implement final regulations promptly. Therefore, though we do not suggest a shorter period, we believe that the Agencies should issue final regulations promptly and make them effective no later than six months after such final rules are published.

If the Agencies are inclined to delay final regulations due to uncertainty about their effect, we urge you to proceed promptly and let the marketplace tell you whether changes are needed. The marketplace will provide a more objective perspective on the efficacy and appropriateness of the regulations than any one or collection of commentators. The proposed regulations are not exclusive, allowing payment system participants to develop alternative enforcement procedures in case the regulatory safe harbors prove unworkable. Moreover, as technology develops, new enforcement systems — and new evasion schemes — are likely to develop. We suggest that the regulation itself provide for frequent periodic review and revision by the Agencies to accommodate new developments in the payment services sector.

We once again thank you for your sincere efforts to write regulations that effectively implement UIGEA. We will continue to offer our cooperation and assistance to the Agencies, as well as to local, state, federal and international law enforcement, to see that gambling laws, particularly with respect to athletic competitions, are effectively enforced.

Sincerely,

\s\ Rick Buchanan
Executive VP and General Counsel
National Basketball Association

\s\ Elsa Kircher Cole
Vice President for Legal Affairs and General Counsel
National Collegiate Athletic Association

\s\ William Daly
Deputy Commissioner
National Hockey League

\s\ Tom Ostertag
Senior VP and General Counsel
Major League Baseball

\s\ Jeffrey Pash
Executive VP and General Counsel
National Football League