BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

DIVISION OF RESEARCH AND STATISTICS

July 26, 2010

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Center for Regulatory Effectiveness
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Dear Mr. Tozzi:

We have received your amended petition, dated March 29, 2010 ("Petition"), under the Board's Information Quality Guidelines ("IQGs") requesting revision of statements in the preamble of the final rule promulgated by the Board and the Department of the Treasury (together, the "Agencies") as required by the Unlawful Internet Gambling Enforcement Act of 2006 (the "Act"). The Petition claims that certain statements made in the preamble of the Federal Register notice for the final rule are not accurate or reliable and lack utility as contemplated by the Board's IQGs. In addition, the Petition claims that statements regarding the non-exclusive examples of reasonably designed policies and procedures lack a transparent and reasonable basis. The Petition also objects to the inclusion of the non-exclusive examples regarding due diligence in the final rule claiming they are not reasonably designed to prevent or prohibit restricted transactions. Finally, the Petition claims that the final rule does not meet requirements of the Paperwork Reduction Act (PRA).

The Board's IQGs are intended to guard against incorrect factual data being maintained and disseminated and to provide a procedure for affected persons to seek correction of data that may directly benefit or harm them. The Petition is challenging policy decisions made by the Agencies in a rulemaking after notice and comment.[1] Accordingly, staff believes that the IQGs do not apply to the claims made by the Petition. Nevertheless, staff has considered the issues raised by the Petition. For the reasons set out below, staff believes that the Petition's claims are without merit and do not warrant

[1] In addition, the Board's procedure for seeking correction of information under the IQGs states that the public may submit a comment regarding the quality of information that is disseminated in a proposed rulemaking and the Board will consider such comments during the comment-review process. The procedures state that requesting correction of information through the public comment process is the only means of correction applicable to a rulemaking procedure.
http://www/federalreserve.gov/iq_correction.htm

any new rulemaking or revision of the information provided in connection with the rulemaking.

As an initial matter, the Petition is based on an apparent misunderstanding of the actual requirement contained in the Act and the final rule. The Petition incorrectly claims that "the Act prohibits financial transaction providers (e.g., banks, credit unions) from accepting transactions involving illegal Internet gambling."[2] If true, this would essentially create a strict liability standard for financial transaction providers under the Act. In fact, the Act requires, among other things, that the Agencies promulgate a joint rule that requires designated payment systems and non-exempt financial transaction providers participating in each designated payment system to establish policies and procedures reasonably designed to prevent or prohibit transactions restricted by the Act.[3] The Act also requires that the joint rule identify types of policies and procedures that would be deemed to be reasonably designed to achieve this objective, including non-exclusive examples. If a financial transaction provider establishes and implements reasonably designed policies and procedures to prevent restricted transactions, the financial transaction provider will be in compliance with the final rule and the Act, even if it does not prevent all restricted transactions.

Section 6 of the final rule provides non-exclusive examples of policies and procedures that the Agencies deemed to be reasonably designed to prevent or prohibit restricted transactions in accordance with the Act. In the *Federal Register* notice for the final rule, the discussion of the regulatory action for purposes of Executive Order 12866 states that "In accordance with the Act, section 6 of the final rule contains a 'safe harbor' provision by including non-exclusive examples of policies and procedures which would be deemed to be reasonably designed to identify and block or otherwise prevent or prohibit unlawful Internet gambling transactions restricted by the Act." [4] The "safe harbor" phrase in this sentence is intended to refer to compliance with the requirements of the final rule, not any other statute or regulation.

The Petition interprets this statement as "apparently meaning that if financial transaction providers comply with the provisions they would be immune from any civil or criminal enforcement for participating in unlawful Internet gambling transactions."[5] This assumption is incorrect and the Agencies have not characterized the non-exclusive

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[2] Petition, p.1.

[3] This point was made clear in the preamble to the final rule. In response to a comment, the title of section 5 of the final rule was revised to more accurately reflect the actual requirement to establish and implement reasonably designed policies and procedures, rather than impose a strict liability standard. Final Rule, 73 Fed. Reg. 69382, 69390 (Nov. 18, 2008).

[4] Final Rule, 73 Fed. Reg. at 69396.

[5] Petition, p.2.

examples in the manner suggested by the Petition in any portion of the regulatory record. In fact, the statutory and regulatory record makes it clear that the Act and the final rule do not affect the underlying State and Federal gambling laws, but rather expressly rely on the existing gambling laws. The Act itself states clearly that none of its provisions may be "construed as altering, limiting, or extending any Federal or State law or Tribal-State compact prohibiting, permitting, or regulating gambling within the United States."[6] The Act does not provide the Agencies with the legal authority to promulgate a regulatory safe harbor that would modify the scope of enforcement under any existing State or Federal gambling laws.

The non-exclusive examples in section 6 of the final rule are provided solely for compliance with the Act's requirement that a financial transaction provider participating in a designated payment system establish reasonably designed policies and procedures, and the Agencies have made this point throughout the rulemaking process. For example, in the preamble for the proposed rule, the Agencies explained that they would not attempt to further define gambling-related terms because the Act focuses on payment transactions and relies on prohibitions on gambling contained in other statutes "under the jurisdiction of other agencies."[7] The regulatory record is clear that the Agencies do not have authority to provide "safe harbors" from enforcement under other rules or statutes, as suggested by the Petition.

The Petition similarly mischaracterizes a statement in the preamble to the final rule describing the role of a State gambling license in the due diligence process suggested in the non-exclusive examples of reasonably designed policies and procedures. The flexible, risk-based due diligence approach in section 6(b) of the final rule generally suggests that, prior to establishing a relationship with a commercial customer, the participant ask the commercial customer for additional documentation, depending on the participant's judgment of the risk of restricted transactions posed by the commercial customer. Among the documentation that section 6(b) suggests a participant obtain from a commercial customer engaged in an Internet gambling business is a copy of the commercial customer's license "that expressly authorizes the customer to engage in the Internet gambling business issued by the appropriate State or Tribal authority."[8] In the preamble discussion of section 6(b), the Agencies stated that "the participant should be able to rely on that State agency's ability to implement its own gambling laws in a manner that does not violate the law of another State or Federal law."[9] The Petition

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[6] 31 U.S.C. § 5361(b). This statutory provision is reflected in the final rule. 12 CFR 233.1(a); 31 CFR 132.1(a).
[7] NPRM, 72 Fed. Reg. at 56682.
[8] 12 CFR 233.6(b)(b)((ii)((B)(1).
[9] Final rule, 73 Fed. Reg. at 69392.

claims that the statement does not comply with the Board's IQGs because "[a] State gambling license does not provide reasonable assurance of compliance with the 'patchwork' of laws and caselaw interpretations of other States and other Federal laws."[10]

At no point in the regulatory record did the Agencies indicate that obtaining such a license would be a guarantee that the commercial customer's activities would, in all instances, comply with all applicable State and Federal gambling laws. The issue addressed by the statement cited by the Petition was simply the type of documentation that the Agencies believed would be reasonable to expect a participant to obtain from a commercial customer and rely on as evidence of lawful activity prior to opening a customer relationship with that commercial customer in order to comply with the Act. The Agencies believe it is reasonable and appropriate for a participant to rely on a State gambling license "that expressly authorizes the customer to engage in the Internet gambling business" as evidence that a commercial customer's Internet gambling activities are lawful prior to opening a customer relationship.[11] If a State specifically licenses Internet gambling activities, it is reasonable to assume that the State will have considered the risks involved with Internet gambling, including compliance with other Federal and State law, when creating the license. The Act excludes from the definition of "unlawful Internet gambling" any bet or wager expressly authorized by the laws of the State where is it made if such State law includes requirements for age and location verification and appropriate data security standards to prevent unauthorized access.[12] Any State specifically authorizing Internet gambling in reliance on this provision would have to comply with these standards. Of course, the issuance of such a license could not guarantee that the licensee would not introduce restricted transactions into the payment system in the future.

Similarly, in explaining another step in the suggested due diligence procedures, the preamble to the final rule stated that participants could deem commercial customers that are agencies, departments, or divisions of the Federal government or a State government to present a minimal risk of engaging in an Internet gambling business because "participants should be able to assume that their activities are lawful."[13] Again, that statement does not mean that the activities of the governmental commercial customers would, in all cases, comply with all applicable State and Federal laws. For

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[10] Petition, p.4.

[11] If a commercial customer does not have such a license, the final rule suggests that the participant obtain a reasoned legal opinion that the commercial customer's Internet gambling business does not involve restricted transactions. 12 CFR 233.6(b)(2)(ii)(B)(1)(i). Similar to a State-issued license, however, a reasoned legal opinion could not guarantee that a commercial customer would never process a transaction that may violate a State or Federal law.

[12] 31 U.S.C. § 5362(10)(B).

[13] Final rule, 73 Fed. Reg. at 69392.

example, one could conceive of a scenario where a dispute arises between States regarding the Internet lottery sales of one State that arguably are not permitted by the gambling laws of the other State. If such a dispute arose, however, it should be addressed between the State governments themselves. It would be unreasonable to put the private-sector participant in the position of having to pass judgment on the activities of a State government.

Finally, the Petition asserts that the Agencies failed to demonstrate that the non-exclusive examples in section 6 of the final rule meet the practical utility standards in the Information Quality Act and PRA.[14] First, staff believes that the PRA would not apply to the non-exclusive examples that the Petition claims should be revised because the non-exclusive examples are not "collections of information" under the PRA. Section 6(a) of the final rule states that the examples of policies and procedures set out therein are non-exclusive. In addition, the section states that a non-exempt participant is permitted to design and implement policies and procedures tailored to its business that may be different than the examples provided in section 6. Board staff does not believe that these examples meet the definition of a "collection of information" because a "collection of information" is defined as identical disclosure requirements imposed upon 10 or more persons.[15] Second, even if those provisions were deemed to be "collections of information," they clearly have practical utility as non-exclusive examples of policies and procedures that, as required by the Act, the Agencies deem to be reasonably designed to prevent or prohibit restricted transactions. "Practical utility" is defined by Office of Management and Budget regulations implementing the PRA as a person's ability to receive and process that which is disclosed in a third-party disclosure.[16] Staff believes that financial transaction providers should be reasonably able to receive and process the commercial customer's documentation. As explained above, the examples would also have practical utility under the IQGs for purposes of complying with the Act and the final rule.

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[14] The Petition states on pages 6-7:

> The safe harbor statements lack utility in actually providing safety to financial transaction providers in ensuring immunity from violations of various State laws not covered by a commercial customer's State license and from violations of other Federal laws such as the Travel Act, the Wire Act, and the Interstate Horseracing Act. In addition, the general public, on whose behalf the Act and its regulations were promulgated, cannot be assured that the safe harbor statements will lead financial transaction providers to reliably block all illegal gambling activities under all State and Federal laws.

[15] 5 CFR 1320.3(c).

[16] 5 CFR 1320.3(l).

For the reasons set out above, and other facts of record, the staff believes that the statements cited by the Petition, as statements of the Agencies' determinations regarding non-exclusive examples of reasonably designed policies and procedures, are accurate, reliable, and provide practical utility to financial transaction providers. In addition, the Petition does not contain any other compelling argument for revising any of the information provided in connection with the rulemaking. Accordingly, the Petition is denied.

Sincerely,

Michelle E. Shore

Michelle E. Shore
Chief, Financial Reports
Division of Research and Statistics
Board of Governors of the Federal Reserve System