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Proposal: Prohibition on Funding of Unlawful Internet Gambling

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Jennifer J. Johnson, Secretary Board of Governors of the Federal Reserve System 20th Street and Constitution Avenue, NW Washington, DC 20551 Re: Comments on the Joint Proposal Implementing provisions of the Unlawful Internet Gambling Act of 2006 – Docket No. R-1298 Dear Ms. Johnson: The Consumer Financial Services Committee of the State Bar of California (“CFSC”) wishes to thank you for the opportunity to present comments on the above-referenced proposal. While appreciative of the intent of the proposed legislation, the CFSC believes that the Act, as written, is unworkable and places an unfair burden on financial institutions and the payment systems industry. The CFSC has read each of the comments submitted thus far. Many of these comments are well thought out, detailed presentations of the pros and cons of the Act. Rather than repeat these same arguments here, the CFSC sets forth herein – in broad, general terms – some reasons why the Act is problematic from a logistical and an enforcement standpoint. **SIX-MONTH LEAD TIME:** Given the complexity of the task at hand, six months is simply too short a time to implement the final regulations. In particular, financial institutions, payment systems, and other related entities which have a national, or even global, presence will have to research and analyze the various federal and state laws, as well as tribal laws, etc. for each jurisdiction where business is done. Procedures have to be put in place to capture "illegal" gambling transactions – that is, differentiate them from legal transactions and flag such unauthorized transactions, in a way that won't improperly impact a legitimate customer's business. Given the hurdles in implementing such software, hardware, and other processes to differentiate and capture illegal gambling, more effort will likely be required to set up and train employees in new policies and procedures designed to perform due diligence in the initial customer interview process, and in regular analyzing of account activity of otherwise legal gambling institutions to ensure their transactions do not violate the Act. This is a huge undertaking, and six months

is not enough time to put these processes in place. **TERMS AND DEFINITIONS:** The Terms and Definitions section of the proposed Act is hopelessly vague and ambiguous with respect to the term "unlawful Internet gambling." The Act admittedly fails to specify which gambling activities are legal or illegal. Moreover, as the Act states, such determination as to whether gambling is legal or illegal varies from jurisdiction to jurisdiction. Many of the affected and potentially affected participants, e.g., automated clearing house systems, card systems, check collection systems, check clearing houses, wire transfer systems, and participants thereof, have a presence that spans many geographic locales. Expecting them to know, much less keep up with, the many disparate laws of the various states and tribes as to which particular types of transactions are legal or illegal, and to be able to put processes in place to flag and pull illegal transactions (differentiating them from legal ones) is a daunting task. Case in point: The proposed rules themselves make reference, when discussing the rationale for not creating and utilizing a list of unlawful Internet gambling businesses (similar to an OFAC list), the fact that it would be unworkable to expect a government entity to perform this task, which "would require significant investigation and legal analysis," which would 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." In addition, the rule makers are concerned that "a business that engages in unlawful Internet gambling might also engage in lawful activities that are not prohibited by the Act." It is curious, and quite telling, that the private sector is expected to perform the Herculean task that government is admittedly not qualified to handle. Each reason why an OFAC-style list is unworkable is an equally valid reason why private payment systems and their participants should not be expected to shoulder the burden of enforcing the Act. **LIST OF DESIGNATED PAYMENT SYSTEMS:** The Act lists a host of designated payment systems that might be used by a financial transaction provider in connection with an Internet gambling transaction, e.g., automated clearing house systems, card systems, check collection systems, wire transfer systems, etc. Notably, many if not most financial institutions use one, more or all of the above-listed systems. The Act allows a financial transaction provider to rely on proper policies and procedures in place by the payment system; however, this in turn raises several questions. If the financial institution expected to obtain, analyze and interpret for sufficiency the policies and procedures of every payment system, local, regional and national (as well as international) that it does business with? What standards are the financial institution to follow when "auditing" its payment systems operators' policies and procedures? Again, given the myriad of different systems a financial institution utilizes, this is an unworkable task. **EXEMPTIONS:** The CFSC agrees that ACH, wire transfers and check systems should be exempted. However, requiring the participant with the customer relationship to be responsible for prohibiting unlawful Internet gambling is still unworkable. As the Act properly points out, not all Internet gambling is illegal. Absent asking its customers to report whether specific transactions are or are not lawful under the Act, which is in itself a highly suspect endeavor and unlikely to be of much use, there does not seem to be much ability for a financial institution or payment system to flag and capture those specific gambling transactions done through our legitimate gambling house customers that may or may not be in violation of the Act. **ODFI IN AN ACH CREDIT TRANSACTION:** While it may indeed be true that the participant with the customer relationship with the Internet gambling business may be able to ask its customer if it is conducting unlawful Internet gambling transactions, or to represent in the account agreement

that it will not conduct such unlawful transactions, beyond that it would be burdensome to expect the financial institution to police its customers, analyze its customers' transactions vis-à-vis the various hodgepodge of gambling laws in the various states, and determine if the Act is being violated. **REMEDIAL ACTION:** If remedial action includes, as the Act suggests, the imposition of fines, such actions by a private entity, without due process, is bizarre at best. **MONITORING:** Given the vagueness of what is considered unlawful Internet gambling, how does an entity come up with the parameters of what is "suspicious?" • For example, under the Act operators of free online games will have to stop giving points for wins that are redeemable for cash, but not prizes. How is the financial institution or payment system operator to know what type of prize was given? • Fantasy sports leagues are legal, but subject to detailed restrictions. For instance, a fantasy team cannot be composed of the entire roster of an actual team, and statistics for determining the winners cannot be derived from a single play, player, team or event. Does the Act envision that the financial institution, as part of its due diligence, will research every fantasy sports league that it does business with, and every financial transaction associated therewith, to ensure that winnings were in fact derived from more than one play, more than one player, and more than one real-world event? **MERCHANT CODES:** As discussed above, the CFSC is not sure how coding is to work for legitimate gambling enterprise. Are customers going to divulge whether a given transaction among host of many is unlawful? Will they know? Will they tell the truth? Must the financial institutions do the analysis themselves? Thank you for allowing the CFSC this opportunity to share its comments. Sincerely, Stefan Sven Lawrence Chair