Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

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Department of the Treasury
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Washington, DC 20220

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

Subject: Docket Number Treas-DO-2007-0015
Federal Reserve Docket No. R-1298

Dear Mr. Klingman and Ms. Johnson:

This letter responds to the request by the Department of the Treasury and the Board of Governors of the Federal Reserve System (Agencies) for comment on a proposed rule (Proposed Rule) implementing the Unlawful Internet Gambling Enforcement Act of 2006 (Act). 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 (Restricted Transactions). The Proposed Rule requires participants in designated payment systems to establish policies and procedures reasonably designed to thwart Restricted Transactions. 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 where the Agencies believe implementation of such policies and procedures is not reasonably practical.

Under the Proposed Rule, national banks, as "participants" in certain "designated payment systems," would be required to implement policies and procedures reasonably designed to identify and block or otherwise prevent or prohibit Restricted Transactions. The designated payment systems are the Automated Clearing House System (ACH), Card Systems, Check Collection Systems, Money Transmitting Businesses, and Wire Transfer Systems. National

banks' compliance with these requirements would be subject to the exclusive enforcement authority of the Office of the Comptroller of the Currency (OCC).

The OCC supports the goal of implementing the Act in a manner that serves the underlying statutory purposes while not imposing an undue regulatory burden on national banks. We hope that the following comments and recommendations are helpful to the Agencies as they work to finalize the Proposed Rule.

**Extent of Due Diligence and Monitoring**

The Proposed Rule describes in broad outline the types of policies and procedures that 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 that would be deemed to be reasonably designed to identify and block or otherwise prevent or prohibit Restricted Transactions. However, the regulatory text is not clear as to the extent of due diligence and monitoring required by participants and whether policies and procedures can be tailored to reflect the participant's assessment of its risk of being used to process Restricted Transactions. The Agencies provide some guidance in the preamble to the Proposed Rule by stating their expectation that participants' policies and procedures be consistent with regular account-opening practices.[1] The Agencies also note that they anticipate participants will use a flexible, risk-based approach in their due diligence procedures and that the level of due diligence performed will match the level of risk of being used to process Restricted Transactions.[2]

We recommend that the Agencies clarify in the regulatory text that a bank's procedures should reflect the bank's assessment of its risks given the nature of the particular activities and customers. The extent of due diligence should be commensurate with the risk profile of the activities and customer. In addition, we suggest that the Agencies consider whether there are low-risk relationships that can be exempted from this requirement or whether the rule should rely on triggering events (such as high return rates) or aggravating circumstances that would result in enhanced monitoring or due diligence procedures.

**Safe Harbor**

Under the Act, a "financial transaction provider" (defined to include a national bank) that participates in a payment system is deemed in compliance with the regulations prescribed under the Act if it relies on and complies with *conforming* policies and procedures of the payment system (safe harbor). However, the Proposed Rule does not describe separately its requirements for conforming policies and procedures of payment systems as distinct from policies and procedures of financial transaction providers. This feature of the rule may lead to confusion and hinder the ability of national banks to rely on the safe harbor. The rule is not clear on which responsibilities fall to payment systems and which to financial transaction providers. Examples of such ambiguities are the references in the rule to policies and procedures requiring fines of customers that engage in Restricted Transactions and the references to policies and procedures

[1] 72 Fed. Reg. 56680, 56688.

[2] *Id.*

requiring monitoring of websites to detect unauthorized use of the relevant designated payment system's trademarks. It is not clear if the rule intends for national banks to have policies under which they would impose fines and monitor websites or whether it intends the payment system to do so. We suggest that the Proposed Rule be clarified to make this rule clear.

In addition, for purposes of the safe harbor, we suggest the Proposed Rule address how a bank (and its regulator) would determine that the payment system's policies and procedures were compliant.[3] This is particularly important because the safe harbor is only available if the policies and procedures of a particular system "comply" with the requirements of the act. Absent a clear determination of conformance, the scope of the safe harbor will be unacceptably ambiguous. It would also be helpful if the rule or the preamble discussed the process by which clear and uniform determinations on this issue might be made.

**Scope of Exemptions**

In general, in the case of U.S.-only ACH, check collection, and wire transfer transactions, the Proposed Rule would require only participants that have a direct relationship with a gambling business to have policies and procedures to identify and block or otherwise prevent or prohibit Restricted Transactions through these systems. The other participants in each of these systems, such as system operators, would generally be exempt from the requirements of the regulation. We believe that some responsibilities should fall on the system operator in these systems (such as an ACH Operator), especially when third parties, such as third-party senders (discussed below), are involved. For example, the final regulation might include a requirement that system operators report to regulators suspicious transactions that come to the system operator's attention, perhaps by way of data regarding unauthorized returns. The rule could require the system operator to provide such data to the primary federal regulator of the bank involved and would enhance the ability of the bank regulator to oversee bank compliance with the regulation.

**Cross-Border Transactions**

The Agencies note their belief that most unlawful Internet gambling businesses do not have direct account relationships with U.S. financial institutions. In most cases, their accounts are held at offshore locations of foreign institutions not subject to the Act, and Restricted Transactions enter the U.S. through those foreign institutions. In the case of payment transactions for the benefit of these offshore gambling businesses, none of the participants in the U.S. that process the transaction would typically have a direct relationship with the gambling business that receives the payment. Thus, the proposal includes a special rule for cross-border transactions which places responsibilities on the first participant[4] in the United States that

[3] Footnote 17 of the preamble notes that participants in a money transmitting network may be able to rely on the network's monitoring procedures if the participants determine that the network's procedures comply with the requirements of the regulation as applied to the participant. 72 Fed. Reg. 56680, 56689. Would a good faith determination on the part of the participant be sufficient?

[4] There may be a number of domestic and offshore intermediaries that stand between a U.S. bank and an offshore gambling business in cross-border transactions. It would be helpful to clarify the responsibilities of the U.S. bank in these circumstances.

receives the incoming transaction directly from a foreign institution[5] and on the final participant in the United States that transmits an outgoing transaction directly to a foreign institution.[6]

While it is appropriate to apply enhanced controls to cross-border transactions in light of the statutory purposes, it is important that the effectiveness of these controls justifies the regulatory burden involved. The Proposed Rule provides that participants in incoming cross-border transactions should take steps to prevent their foreign counterparty from sending Restricted Transactions through the participant, such as including as a term of its contractual agreement with the foreign institution a requirement that the foreign institution have policies and procedures to avoid sending Restricted Transactions to the U.S. participant. In addition, U.S. participants in incoming and outgoing cross-border transactions are required by the Proposed Rule to have policies and procedures to be followed with respect to a foreign bank or foreign third-party processor that is found to have transmitted Restricted Transactions to, or received Restricted Transactions through, the participant. The Proposed Rule provides that these policies and procedures may address when access through the cross-border relationship should be denied and the circumstances under which the cross-border relationship should be terminated.

It is unclear whether these generally applicable requirements are realistic or are likely to be effective in all cases. The foreign institutions are not subject to the Act and the contractual provisions suggested by the Proposed Rule may be difficult for U.S. banks to negotiate or enforce as a business matter. We recommend clarifying that implementation of these procedures for cross-border transactions is expected to be risk-based. For example, a bank that assesses a new relationship with a start-up foreign sender as high-risk should be expected to implement more robust controls than it would apply to its long-standing relationship with a reputable foreign institution that it assesses as low-risk.

**Third-Party Senders**

The preamble notes that the due diligence requirements for a participant establishing a customer relationship in an ACH system also apply to the establishment of a relationship with any third-party sender. The preamble also notes that before establishing a relationship with a third-party sender, a participant should conduct appropriate due diligence with respect to the third-party sender, including as to the conduct by the third-party sender of due diligence on its originators. We recommend including these points in the regulatory text.

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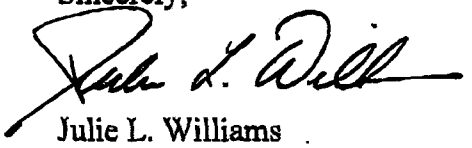
[5] The first U.S. participant in these incoming transactions is to take reasonable steps to ensure that their cross-border relationship is not used to facilitate Restricted Transactions. Incoming transactions include an ACH debit transaction from a foreign gateway operator, foreign bank, or a foreign third-party processor or a check for collection received directly from a foreign bank.

[6] In the case of outgoing wire transfers and ACH credit transactions, the originator's bank or the intermediary bank in the U.S. that sends the wire transfer transaction, or the gateway operator that sends the ACH credit entry, directly to a foreign bank is required by the Proposed Rule to have policies and procedures in place to be followed if such transfers to a particular foreign bank are subsequently determined to be Restricted Transactions.

We appreciate the opportunity to comment on the Proposed Rule.

Sincerely,



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