



# BITS

FINANCIAL SERVICES  
R O U N D T A B L E

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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”)<sup>1</sup> 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 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

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<sup>1</sup> 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.

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.<sup>2</sup> Greater clarity is needed regarding what constitutes “unlawful Internet gambling” given conflicts in the positions advanced by the Departments of Justice and Treasury.<sup>3</sup> 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 left to determine on their own whether and which state or federal laws on gambling apply to a particular transaction.

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<sup>2</sup> 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.”

<sup>3</sup> 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>

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 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. 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; and 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 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.

### ***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 policies 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 policies 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 policies 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.<sup>4</sup> 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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<sup>4</sup> 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.

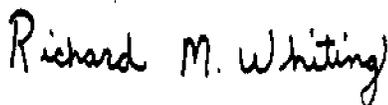
### ***Conclusion***

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,



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The Financial Services Roundtable



Leigh Williams  
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