

Ms Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave NW
Washington DC 20551
Attention: Docket No. R-1298

Treas-DO
Department of the Treasury
Office of Critical Infrastructure Protection and Compliance Policy
Room 1327, Main Treasury Building
1500 Pennsylvania Ave NW
Washington DC 20220
Attention: Treasury Docket No. Treas-DO-2007-0015

December 8, 2007

Dear Madams and Sirs,

I am writing to comment on the proposed rules to implement the Unlawful Internet Gambling Enforcement Act of 2006. As noted in the proposed rule's supplementary information, the Act requires: 1) that financial transaction providers prevent the transfer of funds connected with unlawful internet gambling; 2) that the Agencies ensure that transaction which are not related to unlawful internet gambling are not restricted (a.k.a. "over-blocking"); and 3) that the Agencies exempt restricted transactions from the rules in the event that it is not reasonably practicable to identify and block those transactions.

Problems with the Proposed Rules

The rules, as currently formulated, do not meet these requirements of the Act. The rules do contain a reasonable list of designated payment systems and do provide a reasonable exemption from the rules for intermediary financial transaction providers. However, the rules neither provide a reasonable means of identifying restricted transactions, nor a reasonable means of ensuring that transactions which do not violate the act are not blocked. As a result of these deficiencies the rules may not provide sufficient exemptions for transactions which are not reasonably practicable to identify and block.

The failure of the rules to ensure that restricted transactions are blocked and unrestricted transactions are allowed is due to several factors. Most importantly, the Act relies on other existing state and federal laws to determine what constitutes unlawful internet gambling. The rules provide no guidance as to the scope of these laws, and explain that this would require a careful analysis of state and federal laws and may hinge upon the exact location of the parties involved at the moment the transaction is initiated. If a financial transaction provider cannot reliably identify restricted transactions, the provider cannot block them. Given that the Federal Reserve System and the Department of the Treasury, in consultation with the Department of Justice, cannot determine which

transactions violate the Act, it may be that any attempt to carry out the Act is not reasonably practicable. It is particularly noteworthy that the supplementary information to the rules makes note of the ongoing dispute between the Department of Justice and the horse racing industry as to the legality of interstate transmission of bets and wagers on horse races. How can a financial transaction provider know if they are in violation of the Act, either by failure to block, or by over-blocking, if bets on horse racing are not specifically prohibited or exempted?

Even if a financial transaction provider can come to some reasonable conclusion on which types of transactions are prohibited, it is not clear that they could effectively block those transactions. The supplementary information to the rules provides a very cogent discussion on the difficulty of establishing a list of overseas businesses that engage in unlawful internet gambling. In place of a list, the US financial transaction provider is urged to obtain information from foreign financial transaction providers. Foreign financial transaction providers would be expected to determine the nature of their clients business, and a determination would then have to be made as to whether transactions with that business may violate the act. Given that internet gambling businesses are typically located in jurisdictions where internet gambling is fully legal, it may not be practicable for US based financial transaction providers to obtain this information. For example, privacy laws in the foreign jurisdiction could limit the amount of information that a foreign financial transaction provider can voluntarily provide a US financial transaction provider. Furthermore, the foreign financial transaction provider which is receiving money from the United States may in fact be only an intermediary and may not have a direct business relationship with the final recipient of the transaction. If this is the case the foreign financial transaction provider may have no direct information as to the nature of the business of the final recipient.

Additionally, what if a particular business, such as one in a foreign nation, engages in a gambling business that is in violation of the act and other business, e.g. selling merchandise, that is clearly not in violation of the act? Presumably transactions related to unlawful gambling should be blocked and those to lawful activities should be permitted, but no guidance is given on how to accomplish this.

Finally, in respect to the government establishing a list of unlawful internet gambling businesses, the supplementary information notes that there would be due process requirements – the right of a listed business to appeal their designation. If financial transaction providers are required to produce their own lists of prohibited businesses, it is not clear what if any requirements they will need to meet with respect to an appeals process. If the Act does not require such a process, it may lead to legal action against the financial transaction provider. The Act may provide some protection against to the provider against such actions in US courts but provides no such protection in foreign jurisdictions.

It is also worth noting in this context the recent judgment by the World Trade Organization against the United States and in favor of Antigua and Barbuda in regards to internet gambling. These proposed rules may not be the place to address that particular

ruling. However, the ruling does highlight the fact that rules which encourage over-blocking can have serious legal, political and financial consequences both for the financial transaction provider and for the nation as a whole. Therefore it is incumbent on the agencies to develop a clear set of guidelines that allow financial transaction providers to narrowly tailor their actions against those transactions which are clearly in violation of the Act.

Proposed Modifications

Throughout the proposed rule, the Agencies have relied on a two pronged strategy to implement the Act. First they have first used their exemption authority to limit the financial transaction providers who are covered by the rules (e.g. exempting intermediary institutions) and provide “safe-harbor” provisions for non-exempt providers. Secondly, they have committed to monitoring the effects of the rules and update the rules as the situation warrants, such as monitoring technological developments in payment systems.

The same strategy should be applied to determining what types of transactions should be blocked under the Act. In making these determinations it is useful to separately consider those transactions that may violate federal law, and those that may violate state law.

Assuming that at least one of the parties in the transaction is located in the United States, then federal law will apply to the transaction, regardless of the exact location of the parties at the time the transaction is initiated. As such, it should be feasible to determine which types of transaction are restricted and which are not with respect to federal law. This task is simplified as the Act was not intended to change the legality of any gambling-related activity in the United States {31 U.S.C 5361(b)}. Therefore the only transactions which should be restricted by these rules are those which are unambiguously illegal under federal law. This would clearly encompass sports betting (not including fantasy sports) that is barred by the Wire Act, 18 U.S.C. § 1084 (1961). Other activities which are not clearly illegal, such as bets and wagers on horse racing, or which have been ruled to be legal under federal case law, e.g. poker – see in re MasterCard International., 313 F.3d 257 (5th Circ. 2002), or skill-based games which are not subject to chance (chess, checkers, poker, mahjonn, go, bridge, scrabble etc.) should be exempted. This should not be seen as a legal determination by the Agencies, rather it would be a “safe-harbor” provision that would aid financial transaction providers to implement the Act. The Agencies could then monitor developments in federal law with respect to gambling, either further legislative or judicial action, and modify the rules accordingly. By providing a narrow list of restricted transactions and a clear list of exemptions for legal or ambiguous activities the rules will fulfill the intent of Congress. Clearly restricted transactions will be prohibited, over-blocking will be minimized, and the clear exemptions will make enforcement more reasonably practicable.

With respect to determining which transactions are restricted under state law, much greater obstacles are presented. For these laws it is important to determine where the parties to the transaction are at the time the transaction is initiated. The Agencies must first determine if it is feasible to accomplish this. If it is not possible at the present time,

then all transactions should be exempted with respect to state law. Should the Agencies find that financial transaction providers can make this determination, then the Agencies should proceed to make a similar analysis of state laws using the principals outlined above – those transactions which are clearly illegal should be blocked, all others should be exempted. The Agencies should also examine if the Act is intended to rely only on state law, or should the laws of non-state jurisdictions (the District of Columbia, Puerto Rico, US Virgin Islands, Guam, American Samoa, the Marshall Islands, tribal ordinance etc.) should be analyzed as well. If the Agencies cannot determine what is clearly illegal under state laws, then it should be indisputable that it is not reasonably practicable for financial transaction providers to do so, and all transactions should be exempt with respect to state law.

Regulatory Flexibility and Paperwork Reduction Acts

I would like to make some brief comments with respect to the Regulatory Flexibility and Paperwork Reduction Acts. I would like to request that the Agencies conduct a final regulatory flexibility analysis. I am not convinced that the economic impact on small entities is insignificant. In general, the proposed rules contemplate that small entities will be parts of larger networks, and will therefore be covered under those networks. The proposed rules do not indicate what the responsibility of the small entity is with respect to determining that the larger networks are in compliance with the Act. If a large network, such as an ACH system, merely claims to a small bank that it is in compliance is the small bank in compliance? Or must the small bank make a good faith effort to determine that the larger network is in compliance? This could be particularly difficult for banks in smaller states, US territories, or on tribal land, where there may be little incentive for the larger network to determine if it is in compliance with local law. Finally small entities may have to establish their own policies with respect to check clearing, which may prove burdensome.

With respect to the paperwork reduction act it seems clear from the proposed rules that it will take substantially more than 25 hours to develop policies in compliance with these rules. The supplementary information indicates that the Agencies found it too time consuming to determine what types of transactions should be restricted. It seems safe to assume that if it only takes 25 hours that the agencies would have done so. I would like to request that the Agencies and the OMB make a more realistic and detailed estimation of the burden these rules will place on financial transaction providers once the rules have been revised. This is particularly important as Congress has specifically stated that exemptions should be made from the Act when it is not reasonably practicable to enforce it. A detailed estimate of the burden this Act places on financial transaction providers would be useful in determine what is reasonably practicable.

Finally, I would like to thank the Agencies for this opportunity to comment on the proposed rules and for the work they do on behalf of the people of the United States.

Sincerely,

J Schmit