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VIA ELECTRONIC DELIVERY

December 12, 2007

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Secretary
Board of Governors of the Federal Reserve System
20th St. & Constitution Avenue, NW
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Charles Klingman
Deputy Director
Department of Treasury
Office of Critical Infrastructure Protection and Compliance Policy
Room 1327
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1500 Pennsylvania Avenue, NW
Washington, DC 20220

RE: FRB Docket No. R-1298; Treasury Docket No. DO-2007-0015; Prohibition on Funding of Unlawful Internet Gambling; 72 Federal Register 56680; October 4, 2007

Dear Mr. Klingman and Ms. Johnson:

The following are comments on the proposed Prohibition on Funding of Unlawful Internet Gambling[1] ("Proposed Regulation") issued by the Federal Reserve (Fed) and the Department of Treasury ("Treasury") (collectively, "Agencies"). I currently represent a wide variety of financial services companies that will be impacted by the Proposed Regulation, including foreign and domestic money transmitters, banks, payment processors, and credit card companies. These include UC Group, a payments processor, and Baker Tilly, an independent firm of chartered accountants. I appreciate the opportunity to comment on the Proposed Regulation, which would implement provisions of the Unlawful Internet Gambling Enforcement Act of 2006 ("UIGEA").

The Proposed Regulation is fatally deficient, and requires profound revisions prior to issuance. Its deficiencies include, but are not limited to, the following major issues, along with additional issues that are specifically identified later in this comment:

(1) It fails to meet legal requirements expressly set forth in the text of UIGEA. These include provisions that require the regulations to protect against overblocking, as set

[1] Prohibition on Funding of Unlawful Internet Gambling, 72 Fed. Reg. 56690 (Oct. 4, 2007) (to be codified at 12 C.F.R. § 233 and 31 C.F.R. § 132).

forth in Section 5464(b)(4). These also include provisions that require the regulators to exempt designated payment systems from any requirement imposed under such regulations when it is not reasonably practical to identify and block, or otherwise prevent or prohibit the acceptance of, such transactions, as is set forth in Section 5464(b)(3).

(2) Its failure to identify which transactions are Restricted Transactions and which are not renders the Proposed Regulation so vague as not to provide sufficient notice to those affected by the regulation regarding their compliance obligations.

(3) It would impose costly, extremely burdensome requirements on designated payment systems and covered entities participating in those systems without providing the payment systems or their participants' adequate guidance to enable them to meet the obligations of the law. Notably, with regard to stored value cards and gift cards, it extends coverage to sectors not previously subject to regulations requiring them to identify purchasers, redeemers, or types of transactions, thus requiring those involved in initiating or redeeming payments involving those cards to develop entirely new policies, procedures, systems, and technologies at great cost.[2]

(4) It would create conflicting obligations in a variety of commercial banking relationships both domestically and internationally, as well as threaten to increase the costs to the United States arising from the WTO's finding that the U.S. application of its domestic Internet Gambling laws to foreign operators violated U.S. trade commitments.

(5) It is contrary to the public policy purposes set forth in UIGEA, because if implemented as written, the Proposed Regulation would drive Internet Gambling activity to payment systems not covered by the Proposed Regulation, thereby violating the intent of Congress to stop what is a defined as "Restricted Transaction" under the Act.

(6) At both the technical and substantive levels, the Proposed Regulation does not meet the legal requirements of the Paperwork Reduction Act and the Regulatory Flexibility Act.

I. SUMMARY

- The Proposed Regulation does not provide guidance to financial institutions as to what types of Internet Gambling are legal and which are not, yet requires financial institutions

[2] The Proposed Regulation fails to even acknowledge the cost of such policies, procedures, systems and technologies for those involved in stored value cards, and gift cards, let alone factor such costs into the rule-making process as required by law. Studies undertaken for the Federal Reserve have found the Stored Value Card industry is growing rapidly, involves tens of millions of cards, and is to date essentially unregulated at the federal level. See Stored Value Cards: Challenges and Opportunities for Reaching Emerging Markets, A Working Paper for the Federal Reserve Board 2005 Research Conference, http://www.newyorkfed.org/regional/svc_em.pdf.

to make this determination. Remarkably, the Proposed Regulation states that it would be too burdensome for the federal regulators to make this assessment, yet makes the express finding that it is not unduly burdensome for private sector entities – including small businesses – to do so. The requirement that private sector entities, rather than federal regulators, make judgments about what is and what is not illegal under federal and state law is inherently unreasonable. This is especially the case when such an assessment is central to both the purpose of UIGEA and the ability of the covered entities to meet their legal obligations under it. Covered entities cannot conduct "reasonable due diligence" without knowing specifically what the federal regulators define to be a Restricted Transaction.[3] The Proposed Regulation must specify what types of gambling are "Restricted Transactions" and which are not, and the failure to do so makes it deficient.

- The Proposed Regulation creates a safe harbor for "overblocking," but none for "underblocking." The proposed overblocking safe harbor, in the absence of any counterpart for underblocking, will result in financial institutions engaging in substantial blocking of Internet Gambling transactions that are lawful, in disregard of UIGEA's express mandate that "transactions in connection with any activity excluded from the definition of unlawful Internet Gambling . . .are not blocked or otherwise prevented or prohibited by the prescribed regulations." Section 5364(b)(4). As a result, the Proposed Regulation is deficient.

- The Proposed Regulation would require a covered entity to take certain actions when it "becomes aware" that a customer is receiving restricted transactions. The Proposed regulation provides no definition or clarification as to what level of knowledge is required, creating a legal standard that is so vague and indefinite that those affected by the regulation cannot reasonably be expected to know when an action is actually required by the regulation, making the Proposed Regulation deficient. To correct this deficiency, the Proposed Regulation must define when a covered entity shall be deemed by regulators to "become aware" a customer is receiving restricted transactions.

- The Proposed Regulation's treatment of cross-border transactions and relationships threatens the relationship between U.S. financial institutions and other covered domestic entities and foreign financial institutions with which they have correspondent relationships, by requiring covered domestic entities to engage in intrusive inquiries into the policies and procedures of such foreign institutions relating to their handling of transactions that are lawful in those jurisdictions, as well as transactions that might be restricted. These provisions of the Proposed Regulation go beyond the regulatory

[3] "It is a basic principle of due process that an enactment is void for vagueness if its prohibitions are not clearly defined. Vague laws offend several important values. First, because we assume that man is free to steer between lawful and unlawful conduct, we insist that laws give the person of ordinary intelligence a reasonable opportunity to know what is prohibited, so that he may act accordingly. Vague laws may trap the innocent by not providing fair warning. Second, if arbitrary and discriminatory enforcement is to be prevented, laws must provide explicit standards for those who apply them. A vague law impermissibly delegates basic policy matters to policemen, judges, and juries for resolution on an ad hoc and subjective basis, with the attendant dangers of arbitrary and discriminatory application." *Grayned v. City of Rockford*, 408 U.S. 104 (1972).

requirements set forth in UIGEA, are overly broad and burdensome, and are not necessary to achieve the purposes of UIGEA.

- The Proposed Regulation would require those issuing and selling gift cards and all other forms of stored value cards to put into place mechanisms to prevent their use for restricted transactions, regardless of their value, without any threshold. This constitutes a gigantic expansion of the class of persons covered by the regulation, yet the Proposed Regulation fails to address the numbers of entities that would be covered under this provision, in violation of the Regulatory Flexibility Act, making the Proposed Regulation deficient.

- UIGEA grants the Agencies the authority to exempt certain restricted transactions or designated payment systems from any requirement imposed under such regulations, if the Secretary and the Board jointly find that it is not reasonably practical to identify and block, or otherwise prevent or prohibit the acceptance of, such transactions. Stored value cards and gift cards have not previously been subject to specific federal regulations requiring them to identify the purchasers, redeemers, or use of the cards, and each provide products to tens of millions of U.S. consumers, mostly on an anonymous basis and without systems that restrict use to particular purposes.[4] Moreover, there has been no finding that these products have meaningfully contributed to the facilitation of unlawful Internet Gambling. The costs of imposing the Proposed Regulation on stored value cards and gift cards would be substantial, and the benefit has not been shown to be significant. For this reason, the regulators should make use of the authority provided to them in UIGEA to exempt these types of products from any requirement imposed under the regulations.

- It is not reasonable for those issuing gift cards and other forms of small-value stored value cards that are sold anonymously to determine whether they will be used for Restricted Transactions. The Proposed Regulation should, at minimum, create an exclusion for gift cards and stored value cards below a reasonable dollar value from coverage, through the authority provided them in UIGEA.

- The Agencies provide explicit and detailed explanations of and justifications for their decision not to publish a list of Internet Gambling operators or websites, finding that the creation of such a list would be burdensome for the regulators, likely to be incomplete, subject to ready circumvention, and would require substantial administrative mechanisms to avoid the risk of due process violations. Yet the Proposed Regulation has the practical effect of requiring private sector entities through each covered payment system to create such a list. The same practical objections apply to a private sector list and this is exacerbated by the Proposed Regulation's failure to specify what types of gambling are

[4] Some, but by no means all stored value cards and gift cards can only be redeemed by the entity that issues the card. Many can be redeemed by multiple merchants, many are equivalent to cash and may be used at ATM machines, and many can be redeemed at foreign locations as well as domestic locations, making them usable, for example, at a foreign hotel that offers not only a casino but online gambling from the person's hotel room.

illegal. Moreover, due process concerns are not obviated by shifting the burden to the private sector. The lists would be adopted by the private sector only as a consequence of the state action, embroiling both the regulators, the covered payment systems and the covered entities in essentially identical litigation risks.

- The Proposed Regulation would impose liability on designated payment systems for failing to monitor for the improper use of the payment systems' trademark and take legal action against any misuse. However, it does not take into consideration the cost and difficulty of such monitoring and the costs associated with legal action. It does not specify the frequency required for monitoring, creating a vague and uncertain standard for compliance. Its estimates of that burden do not meet the requirements of the Paperwork Reduction Act.

- The Proposed Regulation would implement the final regulation within six months of its publication, yet provides no objective basis for its conclusion that the policies, procedures, and internal controls required by the Proposed Regulation would be feasibly undertaken in that period, even if the final regulation provides clarity on key issues that is lacking in the Proposed Regulation.

II. DISCUSSION

A. The Proposed Regulation Does Not Define What Transactions Are Illegal And What Transactions Are Not.

The Proposed Regulation treats the fundamental difference of opinion between the Agencies and the Department of Justice ("DOJ") as to what transactions are illegal, and therefore must be blocked, as if the difference does not exist. The DOJ has long taken the position that all Internet Gambling is illegal under the Wire Act of 1961. The DOJ position is that it is illegal to bet on the Internet on horseracing, dog racing, in intratribal activity and intrastate.[5] However, UIGEA clearly exempts three categories of transaction from the definition of "unlawful Internet Gambling." The definition of "unlawful Internet Gambling" excludes: intrastate transactions (bets made exclusively within a single state); intratribal transactions (bets made exclusively within the Indian lands of a single Indian tribe or between the Indian lands of two or more Indian tribes authorized by Federal law); interstate horseracing transactions as permitted under the Interstate Horseracing Act ("IHA"), and certain types of online wagering activities offered by

[5] 72 Fed. Reg. at 56681, n. 1 (noting that the DOJ has consistently taken the position that Internet bets and wagers on horse races violates Federal law and that the Interstate Horseracing Act did not alter than prohibition). Separately, DOJ has advised jurisdictions that would make Internet Gambling lawful that it is illegal even within the confines of their jurisdiction due to its use of a medium, the Internet that crosses jurisdictions for the transmission of information. See letter dated January 2, 2004, from United States Attorney David M. Nissman to Judge Eileen R. Petersen, Chair of the U.S. Virgin Islands Casino Control Commission, in which U.S. Attorney Nissman stated it was the position of DOJ that Internet Gambling was illegal even if it took place intrastate. It is not clear whether DOJ views any type of Fantasy Sports League Internet Gambling to violate federal and/or state laws, although such activities are exempted under UIGEA. The Proposed Regulation does not address the issue, leaving the status of such activities unsettled, too.

Fantasy Sports Leagues.[6] This definition is preserved in the Proposed Regulation, but also states that UIGEA did not amend federal or state laws regarding gambling, which as noted, the DOJ continues to interpret to ban all forms of Internet Gambling, including horse-racing, intra-tribal and intra-state Internet Gambling.

This difference of opinion creates a conflicting legal interpretation by the federal government that makes it impossible for a private sector entity to make a reasonable judgment as to what transactions are restricted and which are not. The only "guidance" provided under the Proposed Regulation is a statement that "the Agencies" preliminary view is that issues regarding the scope of gambling-related terms should be resolved by reference to the underlying substantive State and Federal gambling laws and not by a general regulatory definition."[7]

Thus, a designated payment system (and all covered entities to the extent that they were not relying solely on the rules of the designated payment system) would be required to guess as whether horse-racing, dog-racing, intra-tribal transactions, and intra-state transactions that involve online gambling are lawful, and therefore not restricted, or are not lawful, and there are restricted. The Proposed Regulation does not provide an answer to this question, and it is inherently unreasonable to require covered payment systems and institutions to gamble on whether the federal government will ultimately interpret the answer to come up "red" (restricted) or "black" (unrestricted).

A regulation that refuses to advise covered persons of what activities are subject to the regulation raises constitutional, as well as statutory questions. This is the case when a regulation fails to define an offense with sufficient definiteness that ordinary people can understand what conduct is prohibited and encourages arbitrary and discriminatory enforcement.[8] Here, the Proposed Regulation expressly does not take a position as to what types of transactions are restricted and which are not restricted. As a result, it is fatally defective and must be revised to provide such a definition.

Beyond this fundamental deficiency for failure to define what are Restricted Transactions and what are not Restricted Transactions under federal law is the failure of the Proposed Regulation to provide any guidance on what state laws this federal regulation is seeking to enforce.

As drafted, the Proposed Regulation would require each covered payment system to retain counsel to provide an opinion on the coverage of each and every applicable state gambling law to be able to determine whether a particular transaction involved an unlawful Internet bet or wager and was therefore a Restricted Transaction that must be blocked, making compliance overly burdensome and costly to implement. Deciding which transactions were truly restricted transactions would be extremely difficult, as evidenced by the fact that the Agencies and DOJ are

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[6] 72 Fed. Reg. at 56681.

[7] *Id.* at 56682.

[8] See e.g. *Kolender v. Lawson*, 461 U.S. 352, 357, 103 S. Ct. 1855, 75 L. Ed. 2d 903 (1983), with regard to the standard for a criminal statute. See also *Southeastern Fisheries*, 453 So.2d at 1353, with regard to failure sufficiently to define an offense in a regulation.

unable to provide guidance to covered entities regarding what transactions are restricted and which are not.

The Proposed Regulation does not provide a covered payment system with a mechanism to determine whether its policies and procedures comply with UIGEA. Any judgment they make regarding the coverage of any state law could be challenged as incorrect by federal regulators during the examination process, subjecting them and all covered entities within that designated payment system to liability under UIGEA if found not to be reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions.

For the reasons expressed above with regard to federal law, this approach raises fundamental due process issues under well established Constitutional doctrines applicable to civil as well as to criminal statutes.[9] For a designated payment system and any covered entity to be able to block a restricted transaction because it is illegal under federal or state law, the Agencies must first tell them what those laws prohibit, and therefore, what does constitute a Restricted Transaction and what does not constitute a Restricted Transaction.

In particular, in order to avoid being deficient as overly vague, the regulation needs to state expressly whether the making of payments relating to online gambling on horse-racing is lawful if it meets with the requirements of the Interstate Horseracing Act of 1978; whether the making of payments where the bet or wager is initiated and received or otherwise made exclusively within a single State is lawful when otherwise meeting the requirements set forth in UIGEA if lawful; and similar finding regarding intra-tribal Internet Gambling, and other types of gambling that may be exempt. In addition, the regulation needs to advise which states and tribal areas have been found by the federal government to have in place the required age and location verification requirements and data security standards mandated by UIGEA, thereby providing designated payment systems and covered entities sufficient notice to determine whether a transaction should be deemed to be a Restricted Transaction or not. As discussed below, this could be accomplished by the Agencies providing those subject to regulation under UIGEA with a list of those entities found to be providing lawful Internet Gambling as defined in the Act.

B. The Overblocking Provision Is Overbroad and Will Cause Immediate and Direct Negative Impact To Legitimate U.S. Businesses.

The Proposed Regulation does not meet the legal requirement set forth in UIGEA to prevent overblocking. Under the Proposed Regulation, designated payments systems are provided immunity from liability for blocking transactions that are in fact lawful, if there is a reasonable basis to believe that the transaction may be a restricted transaction.[10] There is no corresponding immunity from liability for failure to block transactions that are ultimately found to have been restricted. Such an immunity would allow designated payment systems and covered entities the ability to reach an independent determination in good faith as to whether a transaction is restricted or not, without being liable for a failure to block one that proves to be

[9] See e.g. *Grayned v. City of Rockford*, 408 U.S. 104 (1972).
[10] *Id.* at 56688.

restricted. The absence of immunity places these systems and entities in the position of having to overblock, or risk liability for inadvertent processing of transactions ultimately deemed to be restricted.

This approach violates the requirements of UIGEA, which requires the federal regulators to ensure that transactions in connection with any activity excluded from the definition of unlawful Internet Gambling are not blocked or otherwise prevented or prohibited by the prescribed regulations.[11] While the Proposed Regulation recites this requirement, it provides no means to designated payment systems and covered entities to carry out the mandate of this requirement, and provides only the "one-way" safe harbor for overblocking, but none for underblocking. This lack of a standard will certainly lead to the blocking of legitimate transactions, despite the fact that UIGEA expressly requires the Proposed Regulation to ensure that non-restricted transactions are not blocked, with the result that consumers engaged in legal online gambling, as well as the institutions involved in the payment process will face costly uncertainties throughout the payment process in connection with transactions that are lawful. No doubt the horseracing and dog racing industries (and their millions of customers) will object to having their transactions suddenly blocked. The near-term economic costs to these lawful industries will be substantial, even apart from the impact of the inevitable litigation required to clarify whether online transactions relating to their industries are lawful and unrestricted, or illegal and Restricted Transactions. There will also be further costs to the federal government due to the need to defend agency action in connection with the issuance and enforcement of the Proposed Regulations.

In the guidance accompanying the Proposed Regulation, the Agencies specified their reasons for not providing a list of companies whose transactions would be deemed to constitute Restricted Transactions. The Proposed Regulation did not address the reverse option, by which the Agencies would provide a list of companies whose transactions would be found to constitute transactions that are *not* restricted, as they fall within the categories of transactions specified in UIGEA as not subject to that definition. Such companies might include, for example, companies providing Internet Gambling services that are lawful under the Interstate Horseracing Act, or which are carrying out Internet Gambling services that are intra-state or intra-tribal and which otherwise meet the mandates of UIGEA. They could also include companies providing Fantasy Sports Internet Gambling in cooperation with sports leagues, and meeting the requirements of UIGEA. Fantasy Sports Internet Gambling, which is reportedly a multi-billion dollar industry,[12] is expressly exempted by UIGEA from coverage, yet may be coded or otherwise treated by participants in the payments system as identical with other forms of Internet Gambling.

It is respectfully requested that the Agencies consider the feasibility of this approach through a system whereby companies engaged solely in those activities expressly specified as not to constitute Restricted Transactions under UIGEA could advise the Agencies that they are

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[11] *Id.* ("[n]othing in this regulation requires or is intended to suggest that designated payment systems or participants therein must or should block or otherwise prevent or prohibit any transaction in connection with any activity that is excluded from the definition of 'unlawful Internet Gambling').

[12] See e.g. "Court Won't Reconsider Decision Favoring Fantasy Sports Leagues," Bloomberg News, November 26, 2007, http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aGSQgvgz.LvI.

engaged in lawful Internet Gambling activities, and be listed as doing so by the Agencies, thereby providing adequate guidance to those seeking to comply with their obligations under the regulation, while providing a mechanism to avoid the overblocking problem.

C. Financial Transaction Providers Are Not Given Sufficient Guidance on Compliance with Proposed Regulation.

Section 5 of the Proposed Regulation requires all non-exempt participants in covered payment systems to establish policies and procedures that are reasonably designed to identify and block restricted transactions. The Proposed Regulation also requires non-exempt financial transaction providers that are participants in a payment system to be in compliance with the Proposed Regulation, but provides that the non-exempt financial transaction provider will be considered in compliance if it relies on and complies with the policies and procedures of the covered payment system in which it is a participant.[13]

The definition of "financial transaction provider" is extremely broad and open-ended, covering essentially any entity participant in a designated payment system.[14] To be in compliance, the financial transaction provider will be required to evaluate the covered payment system's policies and procedures and assess whether they are in compliance with the Proposed Regulation. However, there is no guidance for financial transaction providers as to what level of investigation of the payment system is required, nor is it clear how much information the covered payment systems will be willing to provide, especially given the likely number of financial transaction providers that may be involved. It does not appear that the Agencies have taken into consideration how such an investigation and verification process would work in practice, especially given the general lack of guidance provided to covered payment systems as to what the Agencies will consider reasonably designed policies and procedures.

The Proposed Regulation must be revised to provide guidance to covered entities as to how they are to determine that a designated payments system has established policies and procedures that meet the standard of being reasonably designed to identify and block restricted transactions. One method by which this could be done is for the Agencies to agree to review proposed policies and procedures of each designated payments system and then to issue public notice specifying which designated payments system policies and procedures meet this standard, so that participants in that system may therefore rely on them to gain the benefit of the safe harbor. If the Agencies were to take this approach, the final regulation should also defer requiring any covered entity using any particular designated payments system to adopt policies and procedures to block Restricted Transactions until the regulators have certified such policies and procedures for that type of payment.

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[13] *Id.* at 56697.

[14] *Id* at 56696. The term "financial transaction provider" means "a creditor, credit card issuer, financial institution, operator of a terminal at which an electronic fund transfer may be initiated, money transmitting business, or international, national, regional or local payment network utilized to effect a credit transaction, electronic fund transfer, stored value product transaction, or money transmitting service, or a participant in such network, or other participant in a designated payment system."

D. There is Insufficient Guidance on What Constitutes "Reasonably Designed Policies and Procedures" and Suggested Examples Are Difficult and Costly to Implement

Lack of flexibility.

Section 6 of the Proposed Regulation identifies, by designated payment system, what types of policies and procedures the Agencies will consider to be "reasonably designed to identify and block restricted transactions."[15] The Agencies also expressly state that the list of examples is non-exclusive and that covered payment systems may incorporate different policies and procedures to fit the particular business model.[16] However, under the Proposed Regulation, unless a covered payment system incorporates the identified policies and procedures, it will not be within the safe harbor and could therefore face civil liability for failing to have reasonable policies and procedures. Thus, the approach taken by the Agencies, which might seem to provide for flexibility, essentially mandates a one-size-fits-all approach in which the non-mandatory "examples" will be in practice be mandatory requirements due to the lack of any alternatives qualifying for the safe harbor.

When does a payment system "become aware"?

In the Proposed Regulation, the Agencies require the policies and procedures to implement UIGEA to include procedures the covered payment system will follow when it "becomes aware" that a customer has received restricted transactions.[17] The phrase "becomes aware" if not further defined in the Proposed Regulation. The phrase does not specify an actual level of knowledge; it is unclear if the covered payment system must have "actual knowledge," a mere "reasonable basis to believe," or some other standard. As currently drafted, a covered payment system could be considered to have "become aware" if it receives any sort of notification that a customer received a restricted transaction.

Additionally, the Proposed Regulation does not specify which personnel at the covered payment system would be responsible for having the knowledge that restricted transactions were occurring – would the covered payment system be viewed as "aware" of such transactions if a single individual learns of a restricted transaction, even if that individual is not involved in the underlying policies and procedures required by the Proposed Regulation? Clarifying the meaning of the phrase is extremely important. As currently drafted the Proposed Regulation could be interpreted very broadly, potentially subjecting well-known, well-respected, and highly regulated entities to civil liability and reputational injury for inadvertent failures to take action based on the knowledge of a single, low-level employee.

For this reason, it is respectfully suggested that the Proposed Regulation be revised to provided that the standard for knowledge be specified to require "actual knowledge" and that this

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[15] 72 Fed. Reg. 56698.

[16] *Id.*

[17] *See e.g.*, 72 Fed. Reg. 56699. The requirement applies to all covered payment systems.

"actual knowledge" have been communicated to persons at the covered entity responsible for compliance with the regulations.

What volume or size of restricted transactions triggers penalties on merchants?

Even if the Proposed Regulation included an identifiable standard for the level of knowledge required for the covered payment system to "become aware," the Proposed Regulation does not give sufficient guidance on what volume of restricted transactions would trigger the remedies required by the Proposed Regulations. As drafted, the Agencies proposed that if the covered payment system "becomes aware that the customer has received restricted *transactions*"[18] (emphasis added) it must have policies and procedures in place to address when fines should be imposed against the customer, when the customer should not be allowed access to the system, or when the account should be closed. Thus, as drafted, the Proposed Regulations would require some action to take place against a customer if the covered payment system became aware of *two or more restricted transactions*. Since the value of the restricted transaction could be extremely small, it is possible that the Proposed Regulation would require the covered payment system to close the account of a long-standing, high-volume commercial customer if the covered payment system becomes aware of the customer receiving even two restricted transactions, regardless of how small those transactions might be. Such a requirement would undoubtedly damage the smooth flow of the payment system.

There are several key questions that must be addressed for there to be sufficient guidance on this requirement:

- What transaction size and transaction volume must be reached before the Agencies believe a commercial entity should impose fines, restrict access, or close the account of a commercial customer?

- Is it the position of the Agencies that once an account is closed, the payment system may not reopen the account for that same customer?

- Given the lack of guidance as to what level of knowledge will be required on the part of the covered payment system, to what extent do the Agencies believe the covered payment system should afford the customer the opportunity to provide evidence that the transactions were not restricted transactions?

- What is the Agencies' position where the covered payment system believes a transaction to be restricted but the customer believes it is not a restricted transaction (such as a transaction pursuant to the Interstate Horseracing Act or an intrastate or intratribal transaction)?

[18] 72 Fed. Reg. 56699.

It is respectfully suggested that the Agencies must answer these questions, revise the Proposed Regulation in light of the answers, and provide a further opportunity to affected persons to comment on such answers prior to the issuance of any final regulation.

Screening merchants.

The Proposed Regulation requires covered payment systems to screen potential merchant customers to ascertain the nature of their business and to ensure that they are not involved in accepting restricted transactions.[19] While seemingly straightforward, this requirement is extremely vague as to what level of screening will be required and what level of knowledge of underlying businesses the covered payment system must have.

Several critical questions must be answered to ensure that sufficient guidance is available to covered payment systems subject to this vague requirement.

For example:

- Will the covered payment systems have to perform lengthy, comprehensive background investigations for each potential merchant customer?

- What documentation of that investigation will be required?

- Is the covered payment system obligated to perform periodic reviews of the merchant customer to determine if the merchant customer has become involved in Internet Gambling transactions? If so, how frequently must such reviews be undertaken?

- Do the Agencies contemplate a flexible, risk-based approach to the investigation, such that smaller covered payment systems or those that may have lower-risk businesses are not required to do the same investigation as larger, potentially more risky entities?

- Is there a difference in the type of investigation that should occur with respect to a merchant customer that is a well-known, national retailer as opposed to a less well-known company that may not have a lengthy business history?

- To what extent do the foreign activities of the merchant customer affect the investigation – if the merchant customer is involved in Internet Gambling transactions that are legal in a foreign jurisdiction, would that factor cause concern among the Agencies?

The answers to these questions will have a material impact on the design by each designated payment system of policies and procedures deemed sufficient to comply with the final regulation. It is therefore critical that the answers be provided in a subsequent Proposed

[19] *See e.g.* 72 Fed. Reg. 56698.

Regulation for comment by all affected parties. Because the Information Collection Request relating to the Proposed Regulation is incomplete, the government has yet to take appropriate steps to allow merchants, software firms, and other services providers to covered entities to: 1) become aware that they would be impacted by the proposed rule; and 2) the ways in which they would be impacted. Thus, a further comment period is required to allow these affected firms to effectively participate in the rulemaking.

Rewriting merchant customer agreements.

The Proposed Regulations require covered payment systems to include in merchant customer agreements language that the merchant will not receive restricted transactions.[20] Here again, the Agencies are requiring the individual covered payment systems to determine what is and what is not a restricted transaction; with numerous potential interpretations among the many payment systems. In addition, the Agencies do not indicate whether this requirement applies to existing contracts or only to new customer relationships. This lack of clarity in the Proposed Regulation raises further questions that need to be answered prior to the issuance of a final regulation.

They include:

- Will participants in designated payment systems be forced to reopen existing contracts, or require amendment to existing contracts, to comply with the Proposed Regulations?

- How would the Agencies propose to address situations where the same merchant is faced with contracts from participants in multiple covered payment systems, which may have different interpretations of what constitutes a restricted transaction?

The Proposed Regulation should be revised to specify whether covered entities must revise existing contracts with services providers and with correspondent banking, merchant, and customer relationships to counter the use of each of those relationships for carrying out what might be Restricted Transactions under the regulation. If the final regulation requires revisions to such contracts, it needs to provide for an adequate period for such renegotiations, which in the case of some covered entities could involve hundreds of separate contracts (or more) with banks, merchants, other customers, and services providers. Given the sheer number of contracts that could be affected, and the reality that many of the counterparties to such contracts may be located in other jurisdictions where Internet Gambling activities are lawful, the minimum period allowed for imposing such additional contractual obligations should be no less than one year following the effective date of any final regulation.

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[20] *Id.*

Expanded Government Regulation of Stored Value Cards.

The Proposed Regulation defines "card system" as "...a system for clearing and settling transactions in which credit cards, debit cards, pre-paid cards, or stored value products, issued or authorized by the operator of the system, are used to purchase goods or services or to obtain a cash advance."[21] This definition expressly covers stored value products, many of which are issued with low-dollar limits, typically of less than $500 and often of less than $100. The size of the domestic stored value card industry has been estimated in a 2005 Federal Reserve study to exceed 36 million cards, which also generally does not have mechanisms in place that could be tailored to enable identification of Restricted Transactions. Indeed, the 2005 Federal Reserve study expressly noted that uncertain legal and regulatory conditions may stifle innovation in the industry, as compliance with an increasing number of laws and regulations, particularly at the state level, may make products too expensive to offer. [22] Such cards do not ordinarily today have any controls regarding the person purchasing the card, or the purposes for which the card is used. For this reason, issuers, marketers, sellers, and redeemers most often have no policies or procedures in place to track (or limit) the type of use of the card by the purchaser, as would be required for compliance with the Regulation. Thus, the Proposed Regulation requires an entirely new set of compliance obligations for all those involved with stored value cards, despite the fact that existing federal anti-money laundering laws ("AML") have expressly, to date, exempted them from coverage under existing regulations governing money services businesses.

The reasoning behind the complete exclusion in the final Bank Secrecy Act ("BSA") Money Services Business registration rule of issuers, sellers, and redeemers of stored value card products logically would seem to apply to excluding participants in stored value systems from this Proposed Regulation.

As explained by the Treasury in its final rule:

> The final rule continues to treat ''stored value'' as a financial instrument whose issuers and sellers are financial institutions for purposes of the Bank Secrecy Act. However, the final rule revises the Notice to exempt stored value issuers and sellers from any money services business registration obligation. Under the circumstances, the only immediate consequence of the rule will be to make clear that currency transactions in excess of $10,000 by stored value issuers and sellers require reporting under the Bank Secrecy Act (rather than under section 6050I of the Internal Revenue Code) and that businesses that participate as financial intermediaries in transactions in which stored value is transferred electronically may, if otherwise covered, be subject to the rules requiring the maintenance of records for funds transfers of $3,000 or more.
>
> This limited treatment of stored value—which frees the industry from registration requirements to which issuers and sellers of money orders and traveler's checks will be subject— eliminates the ''chilling effect'' on the technology industry to which

[21] 72 Fed. Reg. 56696.

[22] See Stored Value Cards: Challenges and Opportunities for Reaching Emerging Markets, A Working Paper for the Federal Reserve Board 2005 Research Conference, http://www.newyorkfed.org/regional/svc_em.pdf.

> commenters objected. The limited step that is being taken should create certainty as to the outlines of the Bank Secrecy Act's application to electronic funds equivalents, while allowing further development prior to any rulemaking that deals with more specific issues such as, for example, exemptions for ''closed system'' or small denomination stored value devices or the terms for possible tailored application of the registration or other Bank Secrecy Act requirements to aspects of these emerging payment products.[23]

The BSA regulation providing the exemption to stored value cards and their issuers, sellers and redeemers from coverage under the BSA is now more than eight years old. It has never been revised, and thus entities in these businesses have not been expressly mandated to have policies and procedures in place today covering those products for anti-money laundering purposes unless they are otherwise covered under the BSA. Notably, the BSA regulation expressly recognizes that if regulation of stored value products is ever to come into effect, it may need to provide exceptions for small denomination stored value products to avoid the risk of chilling the entire industry and making otherwise lawful and important consumer financial products unfeasible.

Given this history, it is respectfully suggested that the Proposed Regulation be revised to exempt stored value cards, or at the very least, stored value cards below a threshold amount, pending an overall revision of the status of these cards by the Agencies. The Agencies should not regulate these products through the "back door" of covering them under UIGEA when they have declined to regulate them through previous regulatory processes relating to money laundering, an area of much greater breadth and concern, domestically and internationally, than the far narrow topic of Internet Gambling.

It is respectfully suggested that the Agencies engaged in a further request for comment on the specific question of whether thresholds should be imposed on any coverage of stored value cards to prevent Restricted Transactions, and if so, what an appropriate threshold might be.

New Federal Regulation of Gift Cards.

Remarkably, the Proposed Regulation's definition of cards implicitly includes gift cards, a product that was estimated to amount to a $35 billion domestic U.S. market as of 2005 and to a $76 billion domestic U.S. market in 2006, and which previously have not been regulated by the Federal government.[24] Essentially, none of those involved in the issuance or sale of such cards today have mechanisms in place to determine the identity of the purchasers of the cards, or entities involved in the redemption of the cards for goods or services The Proposed Regulation would seem to require that issuers, sellers, and redeemers of gift cards also have anti-Internet Gambling controls applicable to the cards.

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[23] Financial Crimes Enforcement Network, 31 CFR Part 103, RIN 1506–AA09, Amendment to the Bank Secrecy Act Regulations—Definitions Relating to and Registration of, Money Services Businesses, **Federal Register**/Vol. 64, No. 161 / Friday, August 20, 1999 http://www.fincen.gov/msbreg1.pdf.

[24] http://www.marketresearch.com/product/display.asp?productid=1125176&g=1.
Media accounts suggest the current figure may be closer to $90 billion as of 2007. See e.g. "Card Tricks: Gift Cards Are Big Business for Retailers," http://chiefmarketer.com/cm_plus/gift_cards_retailers/.

Today, gift cards are issued, sold, and redeemed by a wide variety of categories of businesses, from regulated financial institutions, to hotel chains, malls, merchants, telecommunications companies, multinational media conglomerates, among others, and often on a global basis where they can be used throughout the world.

Currently, a gift card in any denomination could be sold, in the United States or in other country, such as the United Kingdom where Internet Gambling is lawful, by a retailer for redemption by that retailer on a global basis, such as by a hotel chain or entertainment company. That chain or company in turn might permit Internet Gambling at any of its facilities in a jurisdiction where such activity is lawful. Under the regulation, the entity issuing such a card, or a merchant acquirer, would need to have policies and procedures in place to restrict its use by a U.S. person engaged in Internet Gambling, and such controls might also *indirectly* apply to the seller of the card, those processing the card, and those redeeming the card, depending on their relationship to the covered entities and to any business involved in Internet Gambling.[25] It appears from the Proposed Regulation that the Agencies consciously intended to cover gift cards, despite the fact that the Federal government has previously left the regulation of gift cards to the individual states.

The burden of a new regulation covering all entities acting as a card system operator, a merchant acquirer, or a card issuer is likely to be substantial. To begin with, many of the issuers (at least) are not financial institutions for BSA purposes. Further, most gift cards are today sold without controls or limitations on the purchaser of the card, that is, anonymously, without requirements for customer identification. Many are sold as "open cards," without controls or limits on the intended use of the card, in terms of specific limits on the types of goods or services that may be purchased. Many gift cards are also sold on a basis that allows them to be used globally, inside the U.S. and outside the U.S. These features make the imposition of controls to block Restricted Transactions involving gift cards virtually unenforceable, in the absence of specific physical, technological restrictions that prevent consumers from purchasing the cards and using them at online merchants, or at overseas locations. Such restrictions would have a dramatic impact on the utility of the gift cards for many entirely lawful purposes.

It is respectfully suggested that the Agencies exempt gift cards entirely from the regulation, relying on the authority granted them in UIGEA to do so when such regulations are not feasible.

If the Agencies do not provide a comprehensive exemption for gift cards, they should provide an explanation as to why gift cards should be subject to regulation under UIGEA but not other Federal laws, and should specify why the Agencies have not decided to use the authority granted them in UIGEA to exempt gift cards from coverage.

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[25] It is not clear from the Proposed Regulation whether such cards would also have to be restricted in their use outside the U.S., given their issuance to a U.S. person in the U.S. Clarity on this point might be facilitated through the provision of a definition in the regulation as to what types of transactions are restricted due to being illegal under federal or state laws and what are not.

Alternatively, the Agencies should at least grant an exemption for gift cards below a threshold amount, pending an overall revision of the status of these cards by the Agencies. As with stored value products, the Agencies should not regulate gift cards through the "back door" of covering them under UIGEA when they have declined to regulate them through other previous regulatory processes. Again it is respectfully suggested that the Agencies engage in a further request for comment on the specific question of whether thresholds should be imposed on any coverage of gift cards to prevent Restricted Transactions, and if so, what an appropriate threshold might be.

Potential Damage to Correspondent Banking Relationships.

Under the Proposed Regulation, covered ACH system participants[26] and check collection systems[27] are required to have policies and procedures in place to ensure that foreign senders or foreign banks do not send restricted transactions to the U.S. and to take action against the foreign bank or sender if they do send restricted transactions to the U.S.

These requirements pose significant problems for domestic financial institutions and payment systems and constitute a mechanism that would export the U.S. prohibition against Internet Gambling to foreign jurisdictions where such transactions are lawful. Internet Gambling is a legal, regulated activity in numerous foreign jurisdictions, including the U.K., and reputable, global, financial institutions process those transactions with regularity. The Proposed Regulation expressly requires U.S. institutions to require foreign banks to agree to identify and block transactions that are unlawful in the U.S. but that may be lawful in the jurisdiction in which the foreign bank exists. This single requirement poses several major problems:

- If the foreign bank refuses to include such provisions in its agreement with the U.S. institution, will the Agencies find the U.S. institution to not have reasonable policies and procedures? Will the U.S. institution thus fall outside the safe harbor?

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[26] 72 Fed. Reg. 56698. ACH operators must have policies and procedures in place "for conducting due diligence in establishing or maintaining the relationship with the foreign sender designed to ensure that the foreign sender will not send instructions to originate ACH debit transactions representing restricted transactions to the receiving gateway operator or third-party sender..." In addition, the ACH system must have "procedures to be followed with respect to a foreign sender that is found to have sent instructions to originate ACH debit transactions to the receiving gateway operator or third-party sender ... which may address (A) when the ACH services to the foreign sender should be denied; and (B) the circumstances under which the cross-border arrangements with the foreign sender should be terminated."

[27] 72 Fed. Reg. 56699. Specifically, check collection systems must have policies and procedures to "(i) [a]ddress methods for conducting due diligence in establishing or maintaining the correspondent relationship with the foreign bank designed to ensure that the foreign bank will not send checks representing restricted transactions to the depositary bank for collection, such as including as a term in its agreement with the foreign bank requiring the foreign bank to have reasonably designed policies and procedures in place to ensure that the correspondent relationship will not be used to process restricted transactions; and (ii) [i]nclude procedures to be followed with respect to a foreign bank that is found to have sent checks to the depositary bank that are restricted transactions, which may address – (A) when the check collection services for the foreign bank should be denied; and (B) the circumstances under which the correspondent account should be closed."

- What if the foreign bank refuses to comply with the U.S. law? Do the Agencies require U.S. institutions to terminate their correspondent banking and other agreements with some of the largest foreign financial institutions in the world?

- If the foreign bank did, for some reason, comply, would they be subject to any liability in their home country for blocking transactions that are legal and legitimate?

Answers to these questions are essential in determining whether a designated payments system can design policies and procedures that are "reasonable" under UIGEA and which also do not create significant risks to the operations of the payments system.

It is vitally important to the designated payments system and covered entities to be provided express guidance as to whether it is necessary to close correspondent relationships with foreign banks that do not agree to halt Restricted Transactions to the U.S. We note that there could be a substantial impact on the efficiency of the payment system if financial institutions in many countries refused to agree not to send Restricted Transactions to the U.S. and as a result were required to terminate correspondent relationships with U.S. banks. Historically, the U.S. Department of the Treasury has been concerned about the implications for the transparency and integrity of the payments system in situations in which foreign financial institutions enter the U.S. payments system indirectly, rather than directly, in order to circumvent U.S. regulatory requirements. There could be substantial negative implications for the U.S. payments system overall were numerous foreign financial institutions to cease to have correspondent banking relationships with U.S. financial institutions. These implications could include substantial inefficiencies in the payment system; a higher cost of doing business in the global marketplace for U.S. financial institutions; a loss of transparency in the U.S. payments system in handling cross-border transactions; and a potential increase in money laundering from other countries due to transactions taking place indirectly as a result of the suspension of correspondent banking relationships that today take place directly.

The Agencies need to determine the extent to which these concerns could constitute significant risks to the payments system, and then provide guidance to designated payments systems and covered entities regarding their obligations concerning foreign relationships that have been found to handle Restricted Transactions in light of the possible impact on the payments system. In light of the importance of the issues highlighted, a further period for comment following the publication of any findings by the Agencies should be provided.

Separately, the Agencies do not specify in the Proposed Regulation how they expect to be able to enforce the Proposed Regulation against a foreign institution in the event the foreign institution decides not to comply with the U.S. law. In light of the inter-connectedness of the international payments system and the goals of UIGEA, the regulation needs to address the issue of circumvention, especially as it relates to such institutions that are accessible from the U.S. For example, the Agencies could require all financial institutions offering accounts online to U.S. persons, wherever located, to impose restrictions on the use of the foreign accounts for Internet Gambling. Indeed, the failure to do so leaves a major mechanism available for circumvention. Yet were such an approach to be included in a regulation, it is not clear how the Agencies would

enforce the regulation. The issue of enforcing the requirements of UIGEA regarding foreign institutions doing business with U.S. persons in the U.S. needs to be addressed in a final regulation.

Ongoing Monitoring for Misuse of Trademark.

The Proposed Regulation requires card systems and money transmitters to incorporate ongoing monitoring of websites to detect unauthorized use of the card system or money transmitter system, including its trademark, in order for the policies to fit within the safe harbor as "reasonably designed to prevent or prohibit restricted transactions."[28] The Agencies expressed a concern that Internet Gambling operators may use an agent to receive restricted transactions on behalf of the Internet Gambling operator, thus avoiding the due diligence efforts of the covered payment system.[29] Such arrangements may involve the unauthorized use of the payment system's trademark as an advertisement on the agent's or Internet Gambling operator's web site.

The Agencies note that some money transmitters subscribe to a service that searches for authorized use of the money transmitters' trademark by other websites.[30] Although there is no additional support offered for this assertion, the Agencies nevertheless rely on it as evidence that money transmitters and credit card systems can and should be involved in ongoing monitoring for such unauthorized use of their trademarks. There is no discussion regarding the cost of such a service, and it is not clear what level of monitoring will be required. This vagueness in the Proposed Regulation requires the designated payments system and covered entities to guess as to the extent of the obligation. Accordingly, the Agencies need to answer the most obvious question about this element of the Proposed Regulation:

- Would the Agencies expect the covered entity to check every mention of it on a website to determine if involves the unauthorized use of the trademark? If so, have the Agencies undertaken a determination regarding the costs of such monitoring to affected persons?

By way of example, a search using the search engine Google for the terms "Western Union" and "Internet Gambling" results in 69,000 hits, a search for "Western Union" and "trademark" yields 194,000 hits, and a search for "Western Union" yields 716,000 hits. Investigating, or even quickly scanning, each hit to determine if there is unauthorized use of the trademark would be, at best, extremely difficult. Moreover, a company such as Western Union may find that it may be lawfully used for Internet Gambling transactions in many countries. Thus, the presence of its trademark on a website would not indicate illegal use. This raises a further question:

- Would the Agencies expect the covered entity to check every use of its service on every website located in all jurisdictions to determine if involves an unauthorized use

[28] 72 Fed. Reg. 56698 (card systems), 72 Fed. Reg. 56699 (money transmitters).
[29] 72 Fed Reg. 56689
[30] *Id.*

as applied to the United States? If so, have the Agencies undertaken a determination regarding the costs of such monitoring to affected persons?

The above example suggests that monitoring could be extremely burdensome for covered entities. The problem is exacerbated because the nature of the Internet is such that any website operator found to be using the trademark in an unauthorized manner could easily move the website and set up at another web address, avoiding any legal action that the covered payment system might initiate.[31]

The Proposed Regulation provides no guidance as to what level of monitoring is required, yet any credit card system or money transmitter that does not undertake ongoing monitoring risks falling outside the Proposed Regulation's safe harbor. It is unlikely that any credit card system or money transmitter will not want to avail itself of the safe harbor, therefore they will have to implement ongoing monitoring of websites or risk facing civil liability for failure to have reasonable policies and procedures.

Additionally, it is not clear what steps the Agencies expect a credit card system or money transmitter to take in the event such unauthorized use is discovered.

E. The "Prohibition" on Internet Gambling Can Be Easily Circumvented Even with the Proposed Regulation

The Proposed Regulation seeks to shut down unlawful Internet Gambling by using the payment system as the choke point in the transfer of funds involved in an Internet wager. However, despite the *regulatory* effort, the Proposed Regulation would not be effective in preventing unlawful Internet Gambling. Even if the Proposed Regulation were implemented as drafted, it would still be possible for a U.S. resident to gamble online, frustrating the fundamental purposes of UIGEA, which the Proposed Regulation seeks to enforce.

Under UIGEA, a U.S. resident could still open a foreign bank account in a jurisdiction where Internet Gambling is legal, and use that account as any other similar type of account – making purchases, online banking, etc. The account could also be used for Internet Gambling, which would not be prohibited by federal U.S. law because the law of the foreign jurisdiction would apply. At such time as the individual wanted to repatriate the funds, the individual could simply transfer all or part of the money to the United States. Provided that the U.S. resident reported the bank account to appropriate U.S. authorities, there is no federal prohibition on an individual gambler having the account or using it for lawful purposes under the law of the jurisdiction where the account is located. Thus, whether the U.S. resident wanted to use the funds in the account to gamble online, pay bills, or make purchases, he or she would be free to do so subject to applicable state laws.

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[31] The Agencies expressly cite the ability of foreign operators to easily take down and restart a website as justification for their inability to provide a list of Internet Gambling sites to covered payment systems. However, the Proposed Regulation does not address the implications of this finding for the ability of covered entities successfully to undertake the monitoring set forth in the Proposed Regulation.

Similarly, it appears that a U.S. resident could use a credit card, stored-value card, pre-paid card or debit card that is issued by a foreign financial institution and usable for a variety of purposes to conduct Internet Gambling activity without violating federal U.S. law.

The Proposed Regulation does not meaningfully address this circumvention problem, with that the result that it sets forth a regulatory regime that would result in discriminatory treatment of U.S. financial institutions and preferential treatment of foreign financial institutions handling the identical transactions for a U.S. person. This is a significant deficiency in the regulation, because the regulation makes no effort to address transactions that take place entirely outside of the U.S. payments system but which are initiated and controlled by U.S. persons.

The reality of ready circumvention undermines the utility of the entire Proposed Regulation, as it imposes enormous costs on designated payments systems and covered entities without achieving commensurate benefits in addressing the policy goals established by UIGEA. For this reason, revisions to the Proposed Regulation should address the circumvention issue. There may be numerous additional regulatory measures that could be taken to reduce the circumvention problem. For example, the regulation could require designated payment systems and all participants in such systems to file suspicious activity reports with Treasury for each incident in which they found they were handling a transaction that might possibly constitute a Restricted Transaction, backed by fines or criminal sanctions for willful non-compliance. The resulting data-base would provide a mechanism for federal law enforcement officials to bring cases not against operators, but against payments providers, and against individual gamblers in violation of state laws limiting gambling. Criminal cases could be brought not only against those involved in sports betting, an area traditionally understood to be covered by the Wire Act, but against those involved in horse-racing, dog-racing, poker, bingo, state-authorized online gambling, online betting in tribal areas, any and all of which appear to be subject to UIGEA based on existing DOJ testimony and prosecutions. Such criminal cases would of course have to be brought on a non-discriminatory basis, covering all types of gambling and all types of persons involved in allegedly improper activity, including persons actually based within the U.S., in a manner that does not involve unequal enforcement of the law or abuse of discretion. The resulting litigation, civil and criminal, from regulations that effectively discouraged circumvention, would surely rapidly clarify the state of the law for all parties, and do much to enforce the goals articulated in UIGEA.

F. The Proposed Regulation Exacerbates the Ongoing WTO Dispute Which Could Cost the U.S. $100 Billion.

Though not directly within the immediate scope of the text of UIGEA, it is worth noting that the Proposed Regulation, if finalized, will exacerbate the existing trade dispute with the WTO, potentially costing the U.S. up to $100 billion. The trade dispute centers on the protectionist treatment by the U.S. of its domestic Internet Gambling businesses. Specifically, the U.S. was challenged by the nation of Antigua, which has a thriving, *legal*, Internet Gambling industry, because the U.S. does not permit foreign entities from engaging in Internet Gambling in the U.S. Antigua noted that the U.S. does not prohibit all Internet Gambling, but rather only allows domestic operators involved in limited activities such as horseracing and dog racing. The

WTO found that the U.S. was in violation of its commitment to the WTO on Internet Gambling and thus was obliged to either change its policies to allow foreign competition or shut down the domestic industry.[32] The U.S. instead chose to withdraw its commitment, which, aside from the dangerous precedent being set, permits injured nations to request compensation from the U.S. It is estimated that the compensation figure could reach $100 billion.

Because UIGEA and the Proposed Regulations expressly state that they do not impact the current legality or illegality of Internet Gambling, they fail to address the core issue in the WTO ruling against the United States. Rather, the passage of UIGEA and the subsequent release of the Proposed Regulation potentially exacerbate the scope of damages faced by the U.S. in compensation for its discrimination against foreign operators due to its Internet Gambling regime and decision to withdraw its trade commitment relating to gaming.

UIGEA grants the Agencies the authority both to exempt certain restricted transactions or designated payment systems from any requirement imposed under such regulations, if the Secretary and the Board jointly find that it is not reasonably practical to identify and block, or otherwise prevent or prohibit the acceptance of, such transactions; and to ensure that transactions in connection with any activity excluded from the definition of unlawful Internet Gambling are not blocked or otherwise prevented or prohibited by the prescribed regulations. Regrettably, the Proposed Regulation does not properly use this authority to minimize the costs to the United States arising from the WTO ruling.

The costs to the U.S. arising from the WTO ruling could be reduced by the Agencies defining what are and what do not constitute Restricted Transactions and ensuring that any definition of Restricted Transactions covers domestic operators identically to the coverage of foreign operators.

G. *The Proposed Regulation Does Not Meet the Requirements of the Paperwork Reduction Act or the Regulatory Flexibility Act*

The Proposed Regulation has not provided "a specific, objectively supported estimate of burden" as required by 44 U.S.C. §3506(c)(l)(A)(iv). By failing to identify all of the parties subject to its mandate, it has provided incorrect and unsupported statements regarding the burden on small businesses. It also has not provided burden estimates for many of the information collection tasks set forth in the Proposed Regulation. In fact, the range of covered entities is enormous, involving not only designated payments systems but many types of participants in those systems, including card operators, money transmitters, issuers of stored value cards, issues of gift cards, redeemers of stored value cards, redeemers of gift cards, merchant acquirers, and depository institutions, among others.

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[32] "United States – Measures Affecting The Cross-Border Supply Of Gambling And Betting Services Recourse To Article 21.5 Of The DSU by Antigua and Barbuda Report Of The Panel, WTO," Available at: Http://Www.Antiguawto.Com/Wto/72article215paneldecision.Pdf.

The Paperwork Reduction Act requires the Agencies to determine the burden for each of these types of businesses to develop and implement policies and procedures (including software costs, training, legal costs, management time, verification/quality checking, etc.) to identify and block restricted gambling transactions. Yet the regulation does not accurately identify the universe of certain categories of those covered, providing no specific numbers for the numbers of entities involved in stored value cards and gift cards that would be subject to the record-keeping requirements associated with cards.

The Regulatory Flexibility analysis states that the Agencies "do not have sufficient information to quantify reliably the effects the Act and the proposed rule would have on small entities."[33] This remarkable assertion is per se evidence that the Agencies have not been able to gather the data necessary to meet their obligations to determine the impact of the proposed rule on small entities as defined in the Regulatory Flexibility Act.

The Agencies need to identify how many small entities would be affected by the Proposed Regulation in connection with their involvement in cards, and on the basis of a full understanding of the implications of the Proposed Regulation (discussed above), revise its estimate of the burden to provide one that meets the statutory requirements of both the Paperwork Reduction Act and the Regulatory Flexibility Act.

H. Regulatory Enforcement

The Proposed Regulation would place enforcement the exclusive regulatory enforcement of (1) the Federal functional regulators, with respect to the designated payment systems and participants therein that are subject to the respective jurisdiction of such regulators under section 505(a) of the Gramm-Leach-Bliley Act and section 5g of the Commodity Exchange Act; and (2) the Federal Trade Commission ("FTC"), with respect to designated payment systems and financial transaction providers not otherwise subject to the jurisdiction of any Federal functional regulators.

We note that for MSBs, this outcome could subject them to the jurisdiction of two different agencies, the FTC for enforcement of UIGEA, and the Internal Revenue Service ("IRS") for enforcement of their anti-money laundering obligations under the BSA. As "Restricted Transactions" are by definition illicit transactions, this would appear to place each federally-registered MSB in the position of having to adopt policies and procedures developed by two different agencies, each of which has the authority to engage in enforcement activity in connection with any alleged violation. Alternatively, the Agencies could take the position that the authority granted the FTC regarding money transmitters is *exclusive*, in which case the IRS would not have authority to examine for compliance with the UIGEA regulation in the course of its examination of a MSB for BSA compliance. Alternatively, the Agencies could find that MSBs are already subject to the authority of the IRS which acts as their existing "functional regulator" within the meaning of this section, and that therefore, the IRS, rather than the FTC, will be the sole regulator over money transmitters for UIGEA purposes.

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[33] Prohibition on Funding of Unlawful Internet Gambling, 72 Fed. Reg. 56690 at 56693.

Clarification of the regulatory oversight of MSBs is required. It is respectfully suggested that MSBs be subject to the authority of only one regulator, and that this be undertaken through the existing examination process mandated under the BSA rather than through a second, separate process involving the FTC.

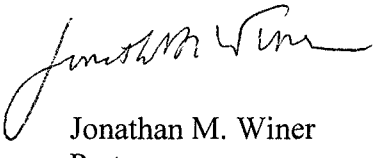
III. CONCLUSION

The Proposed Regulation suffers from numerous deficiencies, which require substantial changes in order for any final regulation not to violate the requirements of UIGEA and other relevant federal laws, including but not limited to the Paperwork Reduction Act and the Regulatory Flexibility Act. These deficiencies are fundamental, and non-trivial, as they make the Proposed Regulation sufficiently overbroad and vague as not to provide sufficient guidance to those affected regarding what actions are lawful and what actions would violate the regulation.

In particular, the Proposed Regulation chooses not to define what types of Internet Gambling transactions are Restricted Transactions and what types of Internet Gambling transactions are lawful. It thus threatens numerous lawful U.S. businesses that have long been engaged in providing Internet Gambling services involving horse-racing, dog-racing, and Fantasy Sports Leagues and which have not been otherwise subject to enforcement activity. It would newly regulate previously undesignated payments mechanisms, such as stored value cards and gift cards, not currently subject to federal regulation; impose unprecedented burdens on participants in the U.S. payments system to monitor the use of their trademarks on a world-wide basis for possible improper use; impose unprecedented due diligence requirements on U.S. financial institutions to monitor, verify, and audit the policies and procedures of their foreign counterparts; and potentially increase the amount of damages the United States could be forced to pay to other countries in connection with the adverse WTO ruling on Internet Gambling. It also threatens significant injury to the payments system due it at minimum complicating and potentially threatening essential relationships of U.S. financial institutions with foreign counterparts.

Unless and until the Agencies make revisions addressing the issues raised in this comment, the Proposed Regulation should not be finalized.

Sincerely,



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