

BITS

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

May 8, 2008

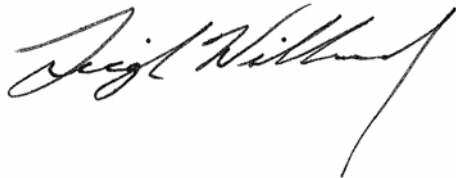
Mr. Thomas Duncan
General Counsel
Committee on Financial Services
US House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

Dear Mr. Duncan,

On April 17th you sent a letter requesting answers to five questions regarding my April 2nd testimony before the Subcommittee on Domestic and International Monetary Policy, Trade, and Technology's hearing on "Proposed UIGEA Regulations: Burden Without Benefit?" Enclosed are answers to these questions in addition to minor edits to the draft transcript.

Please let me know if you have any questions.

Sincerely,

A handwritten signature in black ink, appearing to read "Leigh Williams". The signature is fluid and cursive, with a long, sweeping tail on the final letter.

Leigh Williams
BITS President

Enclosures

Response to Questions on Illegal Internet Gambling Hearing

Q1: Is there any reason that you could not block all transactions to an Internet gambling business that engages in some transactions that clearly violate U.S. gambling laws, such as online sports gambling, even if some other transactions would be legal? [If answer to that they might be held liable for over blocking: How would you like to see the safe harbor clarified to make sure that you can block all transactions for businesses that sometimes violate the law?]

A1: Given the difficulty in defining what is unlawful, any policies and procedures developed by designated payment systems participants could 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. Thus, our financial institution members support the “over blocking” provision in the Proposed Regulation. 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 it sometimes results in the prevention of legal transactions.

Q2: You state that one alternative is to exempt ACH, check and wire transfer systems entirely. Is it not predicable, if this blanket exemption were granted, that all the illegal funds would simply be routed through the exempted systems, rendering the law impotent?

A2: Not necessarily. Financial institutions already devote substantial resources to knowing their customers and identifying suspicious transactions for payments functions including ACH, check and wire transfer systems. Individual firms may have hundreds of people dedicated to anti-money laundering programs, OFAC blocking, and Suspicious Activity Reporting. 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 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.

Q3: You recommend that the regulation should not create “an additional monitoring requirement for entities that are subject to anti-money laundering monitoring and reporting obligations,” and that compliance with existing policies and procedures for anti-money laundering, anti-terrorist financing, OFAC compliance and suspicious activity reporting obligations should be deemed to be in compliance with UIGEA. Could you briefly explain what your current monitoring obligations are under these other requirements, and how they might encompass illegal Internet gambling transactions?

A3: The Bank Secrecy Act requires financial institutions to file reports on suspicious activities (SARs) as well and to implement anti-money laundering compliance programs. Following the 9/11 terrorist attacks, key provisions of the BSA were revised by the USA

PATRIOT Act to criminalize the financing of terrorism, strengthen customer identification procedures, prohibit financial institutions from engaging in business with foreign shell banks, and require financial institutions to have effective due diligence procedures, among other requirements. The USA PATRIOT Act also extended the anti-money laundering compliance program requirements to all financial institutions, including securities firms and insurance companies. Additionally, OFAC regulations prohibit financial institutions from providing services or processing transactions in which identified parties have an interest. These prohibitions have been used to sever terrorists and their supporters and international narcotics traffickers from economic resources.

Essentially, financial institutions are required to know their customers in order to determine if the customer is conducting illegal activity associated with certain types of activities including money laundering and terrorism financing. What is most vexing about the proposed rule implementing UIGEA is that financial institutions would have to detect illegal gambling transactions without knowing whether the activity is legal or illegal. 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 fully define unlawful Internet gambling (based on the underlying UIGEA) places financial institutions 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.

Our member financial institutions are very concerned that even with final adoption of our recommendations, 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 variations in interpretation by regulators and law enforcement agencies. We believe these functions are more appropriate for law enforcement agencies.

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, we recommend 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. We also urge the Agencies to look at liability issues associated with processing restricted transactions that financial institutions are not aware are restricted. If a financial institution has put into place requisite polices and procedures, but is misinformed by its correspondent banks as to the nature of the transaction of the business involved, that financial institutions should not be held liable.

Q4: Could you clarify your position on using credit cards issued on home equity credit lines for Internet gambling transactions? This is an interesting, unique – and troubling – issue you raise, but I'm not sure I understand what you're proposing.

A4: 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. We believe merchants, not financial institutions, are in a much better position to identify an illegal gambling payment and monitor it. 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. 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.

Q5: Setting aside the reasons that the agencies would prefer not to be responsible for setting up a list of illegal online gambling operators, do you think such a list would simplify and strengthen compliance for ACH, check and wire transfer systems?

A5: Overall, the Proposed Rule does not provide adequate detail on the policies and procedures financial institutions must have in place to comply. 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.

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. However, we believe 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. There is precedent in that the Treasury Department currently maintains lists that financial institutions are required to check under OFAC.