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*Unlawful Internet Gambling Enforcement Act and
Regulations Proposed for Its Implementation*

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November 1, 2007

Abstract. Proposed regulations have been announced with a comment period that ends on December 12, 2007, 72 Fed. Reg. 56680 (October 4, 2007) to address the feasibility of identifying and interdicting the flow of illicit Internet gambling proceeds in five pay systems: cards systems, money transmission systems, wire transfer systems, check collection systems, and the Automated Clearing House (ACH) system. It suggests that, except for financial institutions that deal directly with illegal Internet gambling operators, tracking the flow of revenue within the wire transfer, check collection, and ACH systems is not feasible at this point. It proposes exempting them from the regulations' requirements, but invites comments that offer alternative approaches. It charges those with whom illegal Internet gambling operators may deal directly within those three systems, and participants in the card and money transmission systems, to adopt policies and procedures to enable them to identify the nature of their customers' business, to employ customer agreements barring tainted transactions, and to establish and maintain remedial steps to deal with tainted transactions when they are identified. Introductory remarks explain why the Agencies rejected a check-list-of-unlawful-Internet-gambling-operators approach. Several bills have been introduced to augment these efforts, including H.R. 2046 (Internet Gambling Regulation and Enforcement Act), H.R. 2607 (Internet Gambling Regulation and Tax Enforcement Act) and H.R. 2610 (Skill Game Protection Act).



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Unlawful Internet Gambling Enforcement Act and Regulations Proposed for Its Implementation

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Summary

The Unlawful Internet Gambling Enforcement Act (UIGEA) seeks to cut off the flow of revenue to unlawful Internet gambling businesses. It outlaws receipt of checks, credit card charges, electronic funds transfers, and the like by such businesses. It also enlists the assistance of banks, credit card issuers and other payment system participants to help stem the flow. To that end, it authorizes the Treasury Department and the Federal Reserve System (the Agencies), in consultation with the Justice Department, to promulgate implementing regulations. Proposed regulations have been announced with a comment period that ends on December 12, 2007, 72 *Fed. Reg.* 56680 (October 4, 2007).

The proposal addresses the feasibility of identifying and interdicting the flow of illicit Internet gambling proceeds in five pay systems: cards systems, money transmission systems, wire transfer systems, check collection systems, and the Automated Clearing House (ACH) system. It suggests that, except for financial institutions that deal directly with illegal Internet gambling operators, tracking the flow of revenue within the wire transfer, check collection, and ACH systems is not feasible at this point. It proposes exempting them from the regulations' requirements, but invites comments that offer alternative approaches. It charges those with whom illegal Internet gambling operators may deal directly within those three systems, and participants in the card and money transmission systems, to adopt policies and procedures to enable them to identify the nature of their customers' business, to employ customer agreements barring tainted transactions, and to establish and maintain remedial steps to deal with tainted transactions when they are identified. Introductory remarks explain why the Agencies rejected a check-list-of-unlawful-Internet-gambling-operators approach.

Several bills have been introduced to augment these efforts, including H.R. 2046 (Internet Gambling Regulation and Enforcement Act), H.R. 2607 (Internet Gambling Regulation and Tax Enforcement Act) and H.R. 2610 (Skill Game Protection Act).

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Background

Passage of the Unlawful Internet Gambling Enforcement Act (UIGEA) as Title VIII of the SAFE Port Act¹ represented the culmination of legislative consideration that began with the recommendations of the National Gambling Commission.²

UIGEA prohibits gambling businesses from accepting checks, credit cards charges, electronic transfers, and similar payments in connection with illegal Internet gambling.³ It exempts lawful intrastate and intratribal Internet gambling operations that feature age and location verification requirements imposed as a matter of law.⁴ It leaves in place questions as to the extent to which the Interstate Horseracing Act curtails the reach of other federal laws,⁵ an issue at the center of World Trade Organization (WTO) litigation.⁶ It instructs the Secretary of the Treasury and the Board of Governors of the Federal Reserve, in consultation with the Attorney General, to issue implementing regulations within 270 days of passage.⁷

As a consequence of UIGEA and Department of Justice enforcement efforts, NETeller, which reportedly processed more than \$10 billion in gambling proceeds between U.S. customers and offshore Internet gambling business from 1999 to 2007, entered into a deferred prosecution agreement under which it agreed to discontinue U.S. operations, cooperate with investigators, and to pay the U.S. \$136 million in sanctions and to return an additional \$96 million to U.S. customers.⁸ Several offshore Internet gambling companies have apparently sought similar agreements.⁹ A number of large banking institutions, which underwrote the initial public offers for offshore Internet gambling companies on the London stock exchange, have been the targets of grand jury subpoenas as well.¹⁰

¹ P.L. 109-347, 120 Stat. 1952 (31 U.S.C. 5361-5367) (2006).

² National Gambling Impact Study Commission, *Final Report* at 5-12 (1999). Earlier related CRS Reports include CRS Report RS22418, *Internet Gambling: Two Approaches in the 109th Congress*, from which some of this report is drawn, and CRS Report RS21487, *Internet Gambling: A Sketch of Legislative Proposals in the 108th and 109th Congresses*, which includes a more extensive discussion of the legislation's evolution.

³ 31 U.S.C. 5363.

⁴ 31 U.S.C. 5362.

⁵ 31 U.S.C. 5362(10)(D)(iii). The Justice Department and certain members of the horse racing industry disagree over the extent to which the Horseracing Act amends the coverage of the Wire Act which outlaws the interstate transmission by wire of certain information related to gambling. UIGEA simply denies that its provisions are intended to resolve the dispute.

⁶ See e.g., *Don't Bet on the United States's Internet Gambling Laws: The Tension Between Internet Gambling Legislation and World Trade Organization Commitments*, 2007 COLUMBIA BUSINESS LAW REVIEW 439.

⁷ 31 U.S.C. 5364.

⁸ "Neteller to Pay Dollars 136m Gambling Penalty," *Financial Times USA* at 16 (July 19, 2007).

⁹ *Id.*; "Sportingbet Cuts Deal," *Express on Sunday* at 7 (August 5, 2007) ("Sportingbet is now following the lead of rivals PartyGaming and 888 Holdings which started talks with the United States Attorney's Office . . . in a bid to remove the threat of any criminal proceedings. . .").

¹⁰ "Gambling Subpoenas on Wall St." *New York Times* at C1 (January 22, 2007).

Proposed Regulations

On October 4, 2007, the Board of Governors of the Federal Reserve System and the Secretary of the Treasury issued proposed regulations implementing UIGEA, 72 *Fed. Reg.* 56680. The proposal invites commentators to suggest alternatives before the close of the comment period on December 12, 2007 and explains why the two Agencies did not propose a list-of-unlawful-Internet-gamblers approach similar to that used to deny drug dealers and terrorists access to American financial services. It proposes to exempt substantial activities in those payment systems in which tracking is not possible now and in which it may ultimately not be feasible. It also notes that the two Agencies feel that they have no authority to compel payment system participants to serve lawful Internet gambling operators.¹¹

UIGEA calls for regulations that require “each designated payment system, and all participants therein, to identify and block or otherwise prevent or prohibit restricted transactions through the establishment of policies and procedures” reasonably calculated to have that result, 31 U.S.C. 5364(a). The proposal identifies five relevant payment systems: Automated Clearing House System (ACH), cards systems, check collection systems, money transmitting business, and wire transfer systems, proposed 12 C.F.R. §132.3.

The proposal directs participants in the designated systems, unless exempted, to “establish and implement written policies and procedures reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions,” proposed 12 C.F.R. §132.5(a), and then provides examples of reasonably compliant policies and procedures for each system, proposed 12 C.F.R. §132.6. Participants may comply by adopting the policies and procedures of their payments system or by adopting their own, proposed 12 C.F.R. §132.5(b).

Of the five systems, a “card system” as understood by the regulations is one that settles transactions involving credit card, debit card, pre-paid card, or stored value product and in which the cards “are issued or authorized by the operator of the system and used to purchase goods or services or to obtain a cash advance,” proposed 12 C.F.R. §132.2(d). Merchant codes are a standard feature of the system which permits the system to identify particular types of businesses, 71 *Fed. Reg.* 56684 (October 4, 2007). There are no card system exemptions. Examples of reasonably compliant policies and procedures feature due diligence and prophylactic procedural components. The standards involve screening merchants to determine the nature of their business, a clause prohibiting restricted transactions within the merchant agreement, as well as maintaining and monitoring a business coding system to identify and block restricted transactions, proposed 12 C.F.R. §132.6(c).

“Money transmitting businesses” are entities such as Western Union and PayPal that are in the business of transmitting funds, 71 *Fed. Reg.* 56684 (October 4, 2007). They too are without exemption. Examples of the UIGEA-acceptable policies and procedures for money transmitting businesses feature procedures to identify the nature of a subscriber’s business, subscriber agreements to avoid restricted transactions, procedures to check for suspicious payment patterns,

¹¹ “Some payment system operators have indicated that, for business reasons, they have decided to avoid processing any gambling transactions, even if lawful, because among other things, they believe that these transactions are not sufficiently profitable to warrant the higher risk they believe these transactions pose.” The Agencies do not believe UIGEA authorizes them to countermand such a decision, 72 *Fed. Reg.* 56688 (October 4, 2007).

and an outline of remedial actions (fines, access denial, account termination) to be taken when restricted transactions are found, proposed 12 C.F.R. §132.6(e).

The proposal contains exemptions in varying degrees for the other payment systems. In essence, because of the difficulties of identifying tainted transactions, they limit requirements to those who may deal directly with the unlawful Internet gambling businesses. In the case of “check collection systems,” the coded information available to the system with respect to a particular check is limited information identifying the bank and account upon which the check is drawn, and the number and amount of the check, 72 *Fed. Reg.* 56687 (October 4, 2007). Information identifying the payee is not coded and a “requirement to analyze each check with respect to the payee would substantially . . . reduce the efficiency of the check collection system,” 72 *Fed. Reg.* 56687 (October 4, 2007). Consequently, the proposal exempts all but “the first U.S. institution to which a check is transferred, in this case the institution receiving the check deposit from the gambling business,” 72 *Fed. Reg.* 56687 (October 4, 2007); proposed 12 C.F.R. §132.4(b).

Banks in which a payee deposits a check are covered by the regulations as are banks which receive a check for collection from a foreign bank. The proposal offers examples for both circumstances. In the case of a check received from a foreign bank, an example of reasonably compliant policies and procedures would include methods of conducting due diligence to ensure the prevention of tainted transactions and of remedial steps to be considered (collection services denied or correspondent account closed) should the foreign bank be found to be presented tainted checks, proposed 12 C.F.R. §132.6(d)(2). In the purely domestic cases, examples of reasonably compliant policies and procedures would include (1) due diligence in establishing and maintaining customer relations sufficient to identify the nature of a customer’s business, and to provide for a prohibition on tainted transactions in the customer agreement, and (2) remedial action (refuse to deposit a check; close an account) should a tainted transaction be unearthed, proposed 12 C.F.R. §132.6(d)(1).

“Wire transfer systems” come in two forms. One involves a large volume transactions between banks; the second, customer-initiated transfers from one bank to another, 72 *Fed. Reg.* 56685 (October 4, 2007). Like the check collection systems, under current practices only the recipient bank is in a realistic position to determine the nature of the payee’s business. The Agencies sought comments on whether additional safeguards should be required of the initiating bank in such cases, but in the interim exempted all but the bank receiving the transfer, 72 *Fed. Reg.* 56687 (October 4, 2007); proposed 12 C.F.R. §132.4(c).

Banks that receive a wire transfer are covered and examples of reasonably compliant policies and practices resemble those provided for check collection system participants: in purely domestic cases, know your customer, have a no-tainted transaction customer agreement clause, have a remedial procedure (transfer denied; account closed) when tainted transactions surface; in the case of transfers from overseas, know your correspondent bank partner, have a no-tainted transaction agreement, have a remedial procedure (transfer denied; correspondent account closed) when tainted transactions surface, proposed 12 C.F.R. §132.6(f).

The “Automated Clearing House System” (ACH) is a system for settling batched electronic entries for financial institutions. The entries may be recurring credit transfers such as payroll direct deposit payments or recurring debit transfers such as mortgage payments, 72 *Fed. Reg.* 56683 (October 4, 2007). The entries may also include one time individual credit or debit transfers, *Id.* Banks periodically package credit and debit transfers and send them to a ACH system operator who sorts them out and assigns them to the banks in which the accounts to be

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credited or debited are found, *Id.* Participants are identified not according to whether they are transferring credits or debits but according to which institution initiated the transfer, i.e. originating depository financial institutions (ODFI) and receiving depository financial institutions (RDFI), *Id.*

The proposal exempts the ACH system operator, the ODFI in a credit transaction and the RDFI in a debit transaction, proposed 12 C.F.R. §132.4(a). ODFIs in a debit transaction and RDFI in a credit transaction are not exempt under the theory that in any tainted transaction they will be in the best position to assess the nature of the business of the beneficiary of the transfer and to identify and block transfers to unlawful Internet gambling operators, 72 *Fed. Reg.* 56686 (October 4, 2007).

The examples of ACH system reasonably compliant policies and procedures are comparable to those for check collection and wire transfer systems: in purely domestic cases, know your customer, have a no-tainted transaction customer agreement clause, have a remedial procedure (fines imposed; disallow origination of ACH debit transactions; account closed) when tainted transactions surface; in the case of transfers from overseas, know your foreign gateway operator, have a no-tainted transaction agreement, have a remedial procedure (ACH services denied; termination of cross-border relationship) when tainted transactions surface, proposed 12 C.F.R. §132.6(b).

Unlawful Internet Gambling Operators Watch List

The Agencies explained why they do not find a suitable model in a watch list approach similar to that administered by the Office of Foreign Assets Control (OFAC), 72 *Fed. Reg.* 56690 (October 4, 2007).

The OFAC system is a product of the International Economic Emergency Powers Act (IEEPA) which grants the President extraordinary powers to deal with foreign threats to the national security, foreign policy or economy of the United States.¹² The Presidents have exercised their powers under IEEPA to bar financial dealings with various identified drug dealers and terrorists among others.¹³ OFAC maintains an online list of the dealers and terrorists subject to the freeze.¹⁴ It might be thought that assembling a list of known unlawful Internet gambling operators and their fiscal accomplices might work just as well.

The Agencies argue that maintaining such a list would be a time-consuming effort for which they lack the expertise and which would be made more difficult by the complexity of the law in the area and by the ability of gambling operators to take evasive measures, 72 *Fed. Reg.* 56690 (October 4, 2007). Critics might respond that the same arguments ought to apply with at least equal force to drug dealers and terrorists. Certainly, the offshore, open and notorious, publicly traded, Internet gambling operators that the Justice Department has prosecuted and with whom it has entered deferred prosecution agreements might earlier have been identified without great

¹² 50 U.S.C. 1701-1707.

¹³ See e.g., E.O. 12978, Blocking Assets and Prohibiting Transactions With Significant Narcotics Traffickers, 60 *Fed. Reg.* 54579 (October 21, 1995); E.O. 13219, Blocking Property of Persons Who Threaten International Stabilization Efforts in the Western Balkans, 66 *Fed. Reg.* 34777 (June 26, 2001).

¹⁴ 31 C.F.R. ch.V, App.A (July 1, 2006), available on November 1, 2007 at <http://www.treasury.gov/offices/enforcement/ofac/sdn/t11sdn.pdf>.

difficulty or expertise. On the other hand, the effective use of such an approach would require the participation of the Justice Department. It may be that the Department shares the reservations voiced by the Agencies. Yet, it may also be that the Department will take advantage of the comments period to rebut the Agencies' claims.

Proposals in the 110th Congress

At least three bills have been introduced in the 110th Congress to augment UIGEA. The most extensive of these, the Internet Gambling Regulation and Enforcement Act of 2007 (H.R. 2046), introduced by Representative Frank, the Chairman of the House Financial Committee, would establish a federal licensing regime for Internet gambling operators. The second proposal, the Internet Gambling Regulation and Tax Enforcement Act of 2007 (H.R. 2607), introduced by Representative McDermott, would establish a licensing fee regime within the Internal Revenue Code for Internet gambling operators. The third, the Skill Game Protection Act (H.R. 2610), introduced by Representative Wexler, would remove from Wire Act and UIGEA coverage games such as poker, which enthusiasts consider games of skill.¹⁵

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¹⁵ Apparently with games like poker in mind, when defining the bets and wagers within its reach, UIGEA uses the phrase "a game subject to chance," when speaking of prohibited speculation upon contests, sporting events, and games, 31 U.S.C. 5362(1)(A), rather than the phrase "a game predominantly subject to change," which it uses when speaking of prohibited speculation on lotteries, 31 U.S.C. 5362(a)(B). A thorough analysis of these proposals is beyond the scope of this report.