

worldonline gamblinglawreport

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Unlawful Internet Gambling Enforcement Act: e-payments

The Unlawful Internet Gambling Enforcement Act, appended to the SAFE Port Act in October last year, is designed to identify and block payments between US residents and internet casinos. Linda J. Shorey, Holly K. Towle and Sean P. Mahoney, of K&L Gates, highlight the unintentional consequences that the UIGEA could have on the e-payments industry.

Regulations to be promulgated under the UIGEA, if as broad as the statute allows, could impose a compliance burden upon many unsuspecting participants in the payments industry.

Unlawful internet gambling

'Unlawful internet gambling' is defined as 'to place, receive, or otherwise knowingly transmit a bet or wager by any means which involves the use, at least in part, of the internet where such bet or wager is unlawful under any applicable Federal or State law in the State or Tribal lands in which the bet or wager is initiated, received, or otherwise made'. The definition of 'bet or wager' is broad enough to include some ordinary internet promotions because it is defined as risking something of value upon the outcome of a contest or game etc., including a lottery or prize. In short, many companies need to be concerned about the UIGEA, either to ensure that their 'gaming' activities are not covered, or if they are covered, to comment on and/or comply with upcoming regulations.

What the regulations are to address

The UIGEA requires the US Secretary of the Treasury ('Treasury') and the Board of Governors of the Federal Reserve System ('Federal Reserve') to

promulgate regulations that will require action by financial institutions, payments systems and payment system participants. The regulators have until 9 July, 2007 to promulgate regulations to prevent or prohibit the acceptance of 'restricted transactions'.

The definition of 'restricted transaction' in the UIGEA is keyed to the types of payments which those engaged in the business of betting or wagering may not accept. The types of payments involved are far reaching:

- credit, or the proceeds of credit, extended to or on behalf of such other person (including credit extended through the use of a credit card);
- an electronic fund transfer, or funds transmitted by or through a money transmitting business, or the proceeds of an electronic fund transfer or money transmitting service, from or on behalf of such other person;
- any check, draft, or similar instrument which is drawn by or on behalf of such other person and is drawn or payable through any financial institutions; or
- the proceeds of any other form of financial transaction, as the Secretary and the Board of Governors of the Federal Reserve System may jointly prescribe by regulation, which involves a financial institution as a payor or financial intermediary on behalf of or for the benefit of such other person.

Under procedures required by Section 553 of the Administrative Procedure Act and past practice, the Treasury and the Federal Reserve will likely publish proposed regulations in the spring of 2007 to assure ample time for comment and response to comments. The only certainty with such proposed regulations will be controversy.

The regulations are to 'requir[e]

each designated payment system, and all participants therein, to identify and block or otherwise prevent or prohibit restricted transactions [i.e. the unlawful gambling transactions or transmittals of funds which may not be accepted] through the establishment of policies and procedures reasonably designed to identify and block or otherwise prevent or prohibit the acceptance of restricted transactions'. The regulations are to include several examples of policies and procedures designed to identify, block and prevent or prohibit the acceptance of the restricted transactions including, but not limited to, procedures prohibiting the acceptance of products or services of the payment system in connection with a restricted transaction. Such policies and procedures are to be designed not only to block restricted transactions (or the fruits of them), but also to ensure that legal intrastate, intertribal and horseracing transactions are not blocked.

The Treasury and the Federal Reserve, in consultation with the US Attorney General, are given authority to determine which payment systems are 'designated payment systems'.

Conceivably, a 'designated payment system' could encompass such systems as credit/debit networks, wire transfer systems, automated clearing houses, internet payment systems, land-line and cellular telephones and so on, if the regulators view the system as utilized by a 'financial transaction provider' and determine that the system may facilitate a restricted transaction.

Issues surrounding the regulations

While the Treasury and Federal Reserve have not yet made public

any indication of what proposed regulations would look like, we expect that much of the debate and focus will be on three key areas:

- designation or exemption of payment systems;
- exempt transactions; and
- examples of policies and procedures.

Since credit card/debit card networks already block transactions with offshore casinos using the credit card merchant code '7995', it is unlikely that such transactions would be exempted. Proposals to block checks and ACH transfers, however, create significant practical problems. Unlike recipients of funds from credit card and debit card transactions, recipients of checks and ACH transfers are not currently coded, so a new system would need to be created to allow efficient blocking of payments. Given this and the UIGEA's emphasis on reasonable practicality, it is possible that checks or certain ACH transfers could be exempted.

If checks and ACH transfers were not exempted in whole or in part, procedures would have to be included in the regulations to block transactions with internet casinos and other covered entities. There are two obvious possibilities:

- use the '7995' code to identify the 'gambling' recipients of checks and ACH proceeds; or
- use a process similar to that used to block transfers to terrorists.

If the credit card merchant code '7995' were implemented for checks, ACH and wire transfers, all merchant accounts that could accept such payments would have to be coded. This would appear to be a monumental undertaking that could result in enormous expense to the payments industry and its participants, including merchants caught up in any failure of the regulations to ensure that

Recipients of checks and ACH transfers are not currently coded, so a new system would need to be created to allow efficient blocking of payments

unrestricted transactions are not impaired.

If such a procedure were adopted, financial transaction providers would have to ascertain the restricted transactions in which its customers participate. Account establishment and customer identification procedures might become even more complicated than under current regulations. Obtaining information from existing commercial customers may be expensive and time consuming. As with other compliance-related technology that affects financial services, implementation costs will present a much greater burden to smaller institutions as opposed to very large ones that can spread costs over a larger asset base.

Also, a shortcoming in blocking checks and ACH or wire transfers through coding, is the possibility of a lack of international cooperation. All accounts involved in such transactions - including those in foreign jurisdictions - would have to be coded for the system to work. While the Treasury and the Federal Reserve could mandate coding for US financial institutions and other payment system participants, ordinarily they could not impose such restrictions on institutions and participants in offshore jurisdictions where internet gambling is legal.

Another potential procedure for blocking transfers of proceeds by check or ACH transfers would be the use of existing anti-money laundering procedures. Currently, financial services providers are required to block all transactions involving 'specially designated nationals and blocked persons'. A list of prohibited transferees (the 'SDN List') is maintained by the US Office of Foreign Assets Control.

Theoretically, transfers to internet casinos and the like could similarly

be blocked by creating a 'betting or wagering' list akin to the SDN List. An SDN List-type approach would only work with respect to internet 'betting or wagering' companies identified by US law enforcement authorities - financial institutions and other participants could not be expected to keep track of such companies. Also, there is the statutory requirement to ensure that unrestricted transactions are not blocked: it is one thing to block all transfers of funds to a designated terrorist, but the world is not so all-or-nothing for companies that engage in the betting or wagering industry. Those companies are also the recipients of unrestricted checks and ACH transfers, so creating a system that can adequately distinguish a restricted transaction from a transaction that may not be restricted will be challenging, to say the least. However, the burden would be on the company to show it was not a restricted transaction and there are a vast array of issues, beyond the scope of this article, that arise as to the feasibility of a company in the business of betting and wagering raising that challenge, especially if the company accepts bets or wagers from US-based persons.

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