Unlawful Internet Gambling Enforcement Act and Its Implementing Regulations

Charles Doyle
Senior Specialist in American Public Law

Brian T. Yeh
Legislative Attorney

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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 were announced with a comment period that ended on December 12, 2007, 72 *Fed. Reg.* 56680 (October 4, 2007). After taking into consideration the public comments on the proposed rule, the Agencies adopted a final rule implementing the provisions of the UIGEA, 73 *Fed. Reg.* 69382 (November 18, 2008); the rule is effective January 19, 2009, with a compliance date of December 1, 2009.

The final rule substantially resembles the proposed rule, with several modifications in response to public comments. It addresses the feasibility of identifying and interdicting the flow of illicit Internet gambling proceeds in five payment systems: card 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 therefore exempts them from the regulations' requirements. 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. The final rule provides non-exclusive examples of reasonably designed policies and procedures to prevent restricted transactions. The rule also explains why the Agencies rejected a check-list-of-unlawful-Internet-gambling-operators approach, asserting that such a list of businesses would not be practical, efficient, or effective in preventing unlawful Internet gambling. Rather, the Agencies argued that flexible, risk-based due diligence procedures conducted by participants in the payment systems, in establishing and maintaining commercial customer relationships, is the most effective method to prevent or prohibit the restricted transactions.

Several bills were introduced in the 110th Congress relating to Internet gambling, including H.R. 2046 (Internet Gambling Regulation and Enforcement Act), H.R. 2607 and H.R. 5523 (Internet Gambling Regulation and Tax Enforcement Act), H.R. 2610 (Skill Game Protection Act), and H.R. 6870 (Payments System Protection Act of 2008). This report will be updated if similar legislation is introduced in the 111th Congress.

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Background

Passage of the Unlawful Internet Gambling Enforcement Act (UIGEA) in 2006 as Title VIII of the SAFE Port Act[1] 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).

Regulations Implementing UIGEA

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). On October 4, 2007, the Board of Governors of the Federal Reserve System and the Treasury Department (the Agencies) issued proposed regulations implementing UIGEA, 72 *Fed. Reg.* 56680. The proposal invited commentators to suggest alternatives and critiques before the close of the comment period on December 12, 2007. The proposal offered 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 noted that the two Agencies felt that they have no authority to compel payment system participants to serve lawful Internet gambling operators.[11] After taking into consideration the public comments on the proposed rule and consulting with the Department of Justice (as required by the UIGEA), the Agencies adopted a final rule implementing the provisions of the UIGEA, 73 *Fed. Reg.* 69382 (November 18, 2008); the rule is effective January 19, 2009, with a compliance date of December 1, 2009.

Designated Payment Systems & Due Diligence

The final rule identifies five relevant payment systems that could be used in connection with, or to facilitate, the "restricted transactions" used for Internet gambling: Automated Clearing House System (ACH), card systems, check collection systems, money transmitting business, and wire transfer systems, new 31 C.F.R. §132.3. The rule defines a "restricted transaction" to mean any transactions or transmittals involving any credit, funds, instrument, or proceeds that the UIGEA prohibits any person engaged in the business of betting or wagering from knowingly accepting, in connection with the participation of another person in unlawful Internet gambling, new 31 C.F.R. §132.2(y). However, the rule does *not* provide a regulatory definition of the term "unlawful Internet gambling," and instead uses the UIGEA's definition, which relies on underlying federal or state gambling laws.[12]

While the Agencies expect that card systems will find that using a merchant and transaction coding system is "the method of choice" to identify and block restricted transactions, the Agencies felt that the most efficient way for other designated payment systems to comply with the UIGEA is through "adequate due diligence by participants when opening accounts for commercial customers to reduce the risk that a commercial customer will introduce restricted transactions into the payment system in the first place," 73 *Fed. Reg.* 69394 (November 18, 2008).

[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).

[12] "Unlawful Internet gambling means 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 term does not include placing, receiving, or otherwise transmitting a bet or wager that is excluded from the definition of this term by the Act as an intrastate transaction or an intra-tribal transaction, and does not include any activity that is allowed under the Interstate Horseracing Act of 1978." 31 C.F.R. § 132.2(bb).

The rule 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," new 31 C.F.R. §132.5(a), and then provides non-exclusive examples of reasonably compliant policies and procedures for each system, new 31 C.F.R. §132.6. Participants may comply by adopting the policies and procedures of their payments system or by adopting their own, new 31 C.F.R. §§132.5(b), 132.6(a). Participants that establish and implement procedures for due diligence of their commercial customer accounts or commercial customer relationships will be considered in compliance with the regulation if the procedures include the following steps, new 31 C.F.R. § 132.6(b):

1. At the establishment of the account or relationship, the participant conducts due diligence of a commercial customer and its activities commensurate with the participant's judgment of the risk of restricted transactions presented by the customer's business.
2. Based on its due diligence, the participant makes a determination regarding the risk the commercial customer presents of engaging in an Internet gambling business. Such a determination may take one of the two courses set forth below:
    a. The participant determines that the commercial customer presents a minimal risk of engaging in an Internet gambling business (such as commercial customers that are directly supervised by a federal functional regulator,[13] or an agency, department, or division of the federal government or a state government), or
    b. The participant cannot determine that the commercial customer presents a minimal risk of engaging in an Internet gambling business, in which case it must obtain a certification from the commercial customer that it does not engage in an Internet gambling business. If the commercial customer does engage in an Internet gambling business, the participant must obtain: (1) documentation that provides evidence of the customer's legal authority to engage in the Internet gambling business and a written commitment by the commercial customer to notify the participant of any changes in its legal authority to engage in its Internet gambling business, and (2) a third-party certification that the commercial customer's systems for engaging in the Internet gambling business are reasonably designed to ensure that the commercial customer's Internet gambling business will remain within the licensed or otherwise lawful limits, including with respect to age and location verification.
3. The participant notifies all of its commercial customers that restricted transactions are prohibited from being processed through the account or relationship, "through a term in the commercial customer agreement, a simple notice sent to the customer, or through some other method, "73 *Fed. Reg.* 69393 (November 18, 2008).

[13] The term "federal functional regulator" means—the Board of Governors of the Federal Reserve System; the Office of the Comptroller of the Currency; the Board of Directors of the Federal Deposit Insurance Corporation; (D) the Director of the Office of Thrift Supervision; (E) the National Credit Union Administration Board; and (F) the Securities and Exchange Commission. 15 U.S.C. §6809.

Non-exclusive Examples of Compliant Policies and Procedures

Of the five payment 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," new 31 C.F.R. §132.2(f). 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 from the regulations' requirements. 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, new 31 C.F.R. §132.6(d).

"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 from the UIGEA implementing regulations. Examples of 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, and an outline of remedial actions (access denial, account termination)[14] to be taken when restricted transactions are found, new 31 C.F.R. §132.6(f).

The regulations contain 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 final rule exempts all participants in a particular check collection through a check collection system except for "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)—namely, the depositary bank, new 31 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 rule offers examples for both circumstances. In the case of a check received from a foreign bank, examples of a depositary bank's reasonably compliant policies and procedures are procedures to inform the foreign banking office after the depositary bank has actual knowledge[15] that the checks are restricted transactions (such actual knowledge being obtained through notification by a government entity

[14] However, "[a]s the examples in the rule are non-exclusive, a system or participant may choose to include fines in its policies and procedures where appropriate." 73 *Fed. Reg.* 69393 (November 18, 2008).

[15] "Actual knowledge" is defined by the regulation to mean, with respect to a transaction or commercial customer, "when a particular fact with respect to that transaction or commercial customer is known by or brought to the attention of (1) an individual in the organization responsible for the organization's compliance function with respect to that transaction or commercial customer, or (2) an officer of the organization." 31 C.F.R. §132.2(a).

such as law enforcement or a regulatory agency), new 31 C.F.R. §132.6(e)(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, new 31 C.F.R. §132.6(e)(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 public comments on whether additional safeguards should be required of the initiating bank in such cases, 72 Fed. Reg. 56687 (October 4, 2007), but ultimately decided to exempt all but the bank receiving the transfer, new 31 C.F.R. §132.4(d).

Banks that receive a wire transfer (the beneficiary's bank) are covered by the regulations, and examples of reasonably compliant policies and practices resemble those provided for check collection system participants: know your customer, have a no-tainted transaction customer agreement clause, and have a remedial procedure (transfer denied; account closed) when tainted transactions surface, new 31 C.F.R. §132.6(g).

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

The final rule exempts all participants processing a particular transaction through an ACH system, except for the RFDI in an ACH credit transaction, the ODFI in an ACH debit transaction, and the receiving gateway operator that receives instructions for an ACH debit transaction directly from a foreign sender, new 31 C.F.R. §132.4(a). These entities 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 ACH system operator, ODFIs in a credit transaction and RDFIs in a debit transaction are exempt from the regulations, however, *Id.*

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 (disallow origination of ACH debit transactions; account closed) when tainted transactions surface; in the case of receiving 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, new 31 C.F.R. §132.6(c). The Agencies explained that U.S. participants processing *outbound* cross-border credit transactions (ACH credits and wire transfers) are exempted "because there are no reasonably practical steps that a U.S. participant could take to prevent their consumer customers from

sending restricted transactions cross-border," 73 *Fed. Reg.* 69389 (November 18, 2008). The Agencies explained that there is insufficient information to allow U.S. participants to identify and block restricted transactions in cross-border ACH credit transactions and sending wire transfers abroad, *Id.*

Unlawful Internet Gambling Operators Watch List

In the proposed regulations, the Agencies had explained why they did not follow a list-of-unlawful-Internet-gamblers approach similar to that used to deny drug dealers and terrorists access to American financial services, 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.[16] The Presidents have exercised their powers under IEEPA to bar financial dealings with various identified drug dealers and terrorists among others.[17] OFAC maintains an online list of the dealers and terrorists subject to the freeze.[18] It might be thought that assembling a list of known unlawful Internet gambling operators and their fiscal accomplices might work just as well.

After considering the public comments on this issue, the Agencies concluded that maintaining such a list would be a time-consuming effort for which they lack the expertise, and they also questioned its effectiveness, 73 *Fed. Reg.* 69384 (November 18, 2008). The Agencies provided several reasons to support their position that the watch list would be inefficient and ineffective in preventing unlawful activity:

- Because the UIGEA does not precisely define what activities constitute unlawful Internet gambling, but rather refers to activities that are illegal under various federal or state gambling laws, creating such a list would require the Agencies to interpret those laws in a way that might "set up conflicts or confusion with interpretations by the entities that actually enforce those laws."
- The payment transactions may not necessarily be made payable to the business's listed name.
- The list might become quickly outdated to the extent that Internet gambling businesses could quickly change their payments information to evade the law.

Proposals in the 110th Congress

Several bills were introduced in the 110th Congress pertaining to internet gambling. The most extensive of these, the Internet Gambling Regulation and Enforcement Act of 2007 (H.R. 2046),

[16] 50 U.S.C. 1701-1707.

[17] *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).

[18] 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.

introduced by Representative Frank, the Chairman of the House Financial Services Committee, would have established a federal licensing regime for Internet gambling operators. Another proposal, the Internet Gambling Regulation and Tax Enforcement Act of 2007 (H.R. 2607) and Internet Gambling Regulation and Tax Enforcement Act of 2008 (H.R. 5523), both introduced by Representative McDermott, would have established a licensing fee regime within the Internal Revenue Code for Internet gambling operators. The Skill Game Protection Act (H.R. 2610), introduced by Representative Wexler, would have removed from Wire Act and UIGEA coverage games such as poker, which enthusiasts consider games of skill.[19] The Payments System Protection Act of 2008 (H.R. 6870), introduced by Representative Frank, would have prohibited the Agencies from proposing, prescribing, or implementing any regulation called for under the UIGEA, including the proposed regulations, except to the extent that such regulation pertains to unlawful Internet sports gambling. Furthermore, the bill would have required the Agencies to develop and implement regulations that include a definition of "unlawful Internet gambling" and require the Secretary of the Treasury to compile and maintain a list of unlawful Internet gambling businesses; however, such regulations would not have been effective if they "require any person to block or refuse to honor any transaction, or prohibit the acceptance of any product or service of such person, other than in connection with a business on the list maintained by the Secretary."

As of the date of this report, no similar legislation has been introduced in the 111th Congress.

Author Contact Information

Charles Doyle
Senior Specialist in American Public Law
cdoyle@crs.loc.gov, 7-6968

Brian T. Yeh
Legislative Attorney
byeh@crs.loc.gov, 7-5182

[19] 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 the these proposals is beyond the scope of this report.