

Unlawful Internet Gambling Enforcement Act (UIGEA)

Compliance Deadline: December 1, 2009

The UIGEA, signed into law in 2006, was intended to restrict unlawful wagering via Internet gambling sites by individuals through blocking them from making payments to finance their wagers. Banks were expected to modify behaviors that state and federal law enforcement could not. The regulation requires compliance in four general areas:

1. Screening commercial customers at account opening,
2. Policies and procedures to block prohibited transactions conducted via debit and credit cards,
3. Policies and procedures to follow when a commercial account processes restricted transactions, and
4. New notice requirements for commercial customers.

The regulation drafting process was drawn out as the Department of the Treasury and the Board of Governors of the Federal Reserve tried to balance the intent of the legislation without bringing the payment system to a halt. The final rule became effective January 19, 2009, but compliance does not become mandatory for financial institutions until December 1, 2009, more than two years after the rule was released as a proposal and three years after the legislation was passed.

Much of the difficulty in drafting a concise and effective regulation can be attributed to the fact that the UIGEA does not contain a definition of “unlawful Internet gambling” and those drafting the regulations did not believe they were empowered to create one definition. The final rule’s background discussion points out that the Act itself did not determine the difference between illegal and legal gambling and that it was not intended to alter, limit, or extend any Federal, State, or Tribal law prohibiting or regulating gambling. The result is that the law relies on multiple, existing and conflicting state and federal laws. It is difficult for banks to stop payments for something that does not have a definition. The regulation drafters acknowledged this difficulty when they noted that not even the federal government could create a list of Internet gambling businesses for banks to block payments to and from because they could not determine what constituted unlawful Internet gambling and therefore could not create such a list.

Recognizing that it would not be practical to require banks from blocking payments they could not identify as unlawful, the final rule focuses on preventing unlawful Internet gambling businesses from benefitting from the payment system by denying them the opportunity to open bank accounts from which to receive payments. This indirect approach of requiring additional screening of commercial customers posing a risk of acting as unlawful Internet gambling businesses from opening bank accounts meets the UIGEA’s requirements according to the regulation’s drafters. Financial institutions that have the direct customer relationship with commercial account holders bear the responsibility of introducing them into the payments systems.

With the exception of credit and debit card transactions, the final rule does not require policies and procedures specifically for blocking payment transactions. The final rule also mandates disclosures be made to commercial customers regarding the UIGEA's restrictions.

It is also very important to understand what the final rule does not require. Banks are not required to monitor payments in or out of their bank to determine if they are financing lawful or unlawful Internet wagers. Banks are not required to re-investigate the business models of existing commercial customers to assess their likelihood of accepting online wagers. Banks are not required to have written policies and procedures to block ACH, check, or wire payments related to Internet gambling. Banks are not required to allow payments for "lawful" gambling transactions, but can block or "over block" all transactions related to gambling if they choose, without additional liability.

Additional Screening at Account Opening

The final rule attempts to prohibit unlawful Internet gambling businesses from receiving payments by preventing them from opening accounts in the first place. If they have no bank account, then they can't make or receive a payment. By December 1, 2009, banks must have written policies and procedures in place that demonstrate the steps they are taking to prevent a commercial entity acting as an online casino from opening an account. Most banks are meeting these requirements already under the "know your customer" requirements, but they should formally incorporate the UIGEA requirements into their existing procedures in order to demonstrate compliance with the final rule.

When a new customer applies to open an account:

1. Determine whether the account is for an individual or a commercial entity. If it is for an individual no further action is required under the UIGEA final rule.
2. If it is a commercial entity, the bank, as part of its normal due diligence, should assess whether there is a "minimal risk" of it acting as an Internet gambling business. If so, then no further action is required under the UIGEA final rule.
3. If a bank is not able to determine if a commercial applicant has a "minimal risk" of acting as an Internet gambling business, they can rely on the applicant's own certification that they do not operate as an Internet gambling business.
4. If a bank determines that an applicant does operate an Internet gambling business, it can still open the account if additional standards are met including:
 - a. Requiring the applicant to provide evidence of their legal authority to offer online gaming. This evidence could be in the form of a state issued license or an attorney's legal opinion, and
 - b. The commercial entity is required to provide a third party certification that its Internet gambling business has controls in place to prevent improper use of the site by minors or from other individuals in other geographic locations where such gambling would be prohibited and the Internet gambling business must

provide the bank regarding any changes in status of its legal authority to operate.

The UIGEA applies to U.S. banks regardless of the location of their customers. Consider a potential commercial customer located in Costa Rica and operating an Internet gambling business lawfully in that country. The commercial entity applies to open an account at bank branch in Miami. That bank should follow the UIGEA requirements to ensure they are in compliance because although the UIGEA final rule does not apply directly to their foreign applicant, it does apply directly to the bank. What is legal for the online casino in Costa Rica could lead to compliance problems for their U.S. bank.

Banks would not be required to open accounts for businesses operating “authorized” Internet gambling businesses.

Banks would not be required to review existing commercial customers to assess their risk of operating an online casino.

Restricting Card Transactions

Banks will be obligated to establish written policies and procedures to block transactions financing wagers of unlawful Internet gambling that are made via credit and debit cards. It would be impractical for individual banks to be able to monitor and block suspicious individual transactions because of the volume and speed of card authorizations and the issuing bank’s ignorance of the merchants involved. The final rule recognized this and allows banks that issue credit and debit cards to rely on policies and procedures developed by the card system operators (MasterCard, Visa, American Express, Discover) to block prohibited transactions.

The card system operators could meet their obligations by establishing a due diligence procedure reviewing merchants accepting debit or credit cards to determine if they are acting as Internet gambling businesses or they could develop a system of merchant and/or transactions codes for gambling payments that could be blocked. Although it is likely that some version of the “coding solution” will be implemented, the regulation is flexible and either of these approaches could be acceptable or even other models not provided as examples could prove adequate.

Banks will be required to have copies of the card system operators’ policies and procedures that they will be relying upon in their possession by December 1, 2009. Banks will be allowed to rely on the card system operators’ procedures regarding the UIGEA regulation. It is important to note that banks will not have to verify the effectiveness of the card system operators plans in order to meet the requirement. It is expected that federal regulators will review the effectiveness of the card network procedures. As of May 2009, the card system operators had not released their policies and procedures. It is anticipated that they will assign entities that offer online betting a merchant code that can be blocked. It is not certain whether the card system operators will be differentiating between lawful and unlawful gambling when assigning these merchant codes.

The final rule does include an “over blocking” provision that protects banks against claims that they blocked lawful Internet gambling transactions. The final rule affirms the proposed rule’s intent that banks that the UIGEA does not require banks to process lawful gambling transactions. If a bank chooses to “over block” and reject all gambling transactions it would not be out of compliance with the final rule.

Banks should contact their card networks to learn more about the policies and procedures that will be implemented and to obtain copies of those procedures well prior to December 1, 2009.

Policies and Procedures When Restricted Transactions Are Known

Every financial institution that is a non-exempt participant must establish written policies and procedures describing remedial actions it will take if it discovers that a commercial account is processing restricted transactions. The final rule does not mandate any specific actions that must be taken, but relies on each participant to have established policies and procedures in place.

The final rule clarifies in _____.6 *Non-exclusive examples of policies and procedures* the obligations that a non-exempt participant in a designated payment system must adhere to when it gains “actual knowledge” that a commercial account has processed restricted transactions.

It is very important to recognize the narrow definition of “actual knowledge” in the Definition section of the final rule:

(a) Actual knowledge with respect to a transaction or commercial customer means 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.

According to the final rule, actual knowledge is gained when an entity knows or receives a report from a governmental entity such as a law enforcement or regulatory agency that a commercial account is processing restricted transactions. A financial institution that merely has suspicions of restricted transactions, but does not know for certain, is not obligated to initiate the policies and procedures.

When the “actual knowledge” threshold is met, the final rule does not provide participants with a set of standard actions to implement. The overview discussion notes that it will be left to the participants “business judgment” whether it is appropriate to deny the commercial customer access to a particular payment system or to close the account entirely or some other action. However, participants should understand that their regulators will be reviewing the written policies regarding remedial actions.

If a non-exempt participant gains actual knowledge that one of its commercial customers is operating as an Internet gambling business, they are obligated to initiate the proper due diligence to determine if the account holder has the legal authority to do so. This applies to customer accounts opened before or

after December 1, 2009. The commercial account should be required to provide evidence that it is operating with legal authority (state or tribal license or reasoned legal opinion) and that it has the proper safeguards in place to prevent minors and those in more restrictive jurisdictions from placing unlawful wagers.

Commercial Account Notice

The final rule requires that banks communicate to their commercial customers that restricted transactions are prohibited under UIGEA. However, the regulation is flexible regarding how the communication is made. It could be made through a revised commercial account agreement for new customers, via a notice sent to established commercial customers, or possibly even through some other methods including even a notice on the bank's web site as long as the commercial account holders are reasonably likely to receive it. Banks are not required to update account agreements or provide notice with a periodic statement to comply with this UIGEA requirement.

The final rule does not provide model language for the required disclosure. Banks are not obligated to explain the UIGEA requirements or to instruct commercial account holders on the differences between lawful and unlawful gambling. The requirement is simply to inform commercial customers that transactions that are restricted under the UIGEA are prohibited and should not be processed through these commercial accounts.