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# The UIGEA's Final Rule Becomes Law: What Does It Mean for Non-U.S. Financial Institutions?

As of June 1, 2010, financial service providers betting that the compliance measures to prevent unlawful internet gambling would not come into effect today are now holding a losing hand. The long-delayed Final Rule to implement the Unlawful Internet Gambling Enforcement Act ("UIGEA") is now effective and makes compliance with the regulations mandatory.[1]

The Final Rule implements the UIGEA, the law Congress passed in 2006 to stop online gambling in the United States. The UIGEA, among other things, confirmed what had previously been true (but perhaps inadequately understood): it is illegal for financial institutions (wherever located) knowingly to process payments in the United States in furtherance of unlawful online gambling (knowingly processing unlawful gambling payments has always been money laundering). The UIGEA did not create a new law against gambling, just another weapon to combat payments related to unlawful internet gambling. Significantly, the UIGEA also required the Secretary of the Treasury and the Federal Reserve to issue regulations that would place specific compliance obligations on certain financial institutions.

Since the passage of the UIGEA in 2006, there has been a dramatic increase in investigations and prosecutions of online gaming companies, payment processors, and other service-providers to the industry (much of which was due to their pre-2006 activities). High profile prosecutions have imposed liability on non-U.S. companies that transact with U.S.-facing online gambling operators under a variety of U.S. criminal laws, including anti-money laundering statues.

Those prosecutions show no sign of abating with the change in Administration. Nor have efforts to repeal or modify the UIGEA been successful. While implementation of the Final Rule was delayed six months to give covered financial institutions an opportunity to determine whether the Final Rule would apply to their operations and to implement appropriate policies, those who bet on further delay have gambled zero day away.

**Key Issues**




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## I. Brief Overview of the Final Rule

The Final Rule identifies five designated payment systems that could be used to facilitate illegal internet gambling transactions.[2] The Final Rule requires U.S. financial firms that operate, provide or contract for financial transaction services with any such designated payment system, to implement policies and procedures to prevent payments to unlawful internet gambling businesses.[3]

[1] The Final Rule was jointly published on November 12, 2008, by the Federal Reserve and the Treasury Department. Originally scheduled to be implemented on December 1, 2009, it was delayed as a result of lobbying by financial services providers, who argued they could not implement appropriate policies because "unlawful internet gambling" was not actually defined in the UIGEA. A copy of the Final Rule can be found at http://www.treas.gov/press/releases/reports/unlawfuinternetgambling11.12.08.pdf.

[2] Designated payment systems include: (1) Automated Clearing House ("ACH") Systems (e.g., ACH Direct and ECHO); (2) card systems; (3) check collection systems; (4) money transmitting businesses; and (5) wire transfer systems (e.g., SWIFT).

The Final Rule focuses on risk-based due diligence policies and procedures as the primary way participants in designated payment systems can prevent or prohibit restricted transactions.[4] Specifically, U.S. participants[5] must "establish and implement written policies and procedures that are reasonably designed to identify and block or otherwise prevent or prohibit …restricted transactions." Participants are in compliance with the Final Rule if they rely on such written policies and procedures of the designated payment systems. The Final Rule provides several, non-exclusive examples of policies and procedures for the different types of participants, but encourages participants to tailor policies and procedures to individual business needs. Under one example, participants are deemed in compliance with the Final Rule if, at the establishment of the business relationship with a commercial client, the participant conducts due diligence on the client and determines that the client is not involved in an internet gambling business, or obtains a certification from the customer of non-involvement in such a business. If a commercial client is engaged in an internet gambling business, the participant must obtain evidence and certifications that the client is legally involved or does not engage in restricted transactions. Additionally, participants must notify their commercial clients that restricted transactions are prohibited and will be blocked. Finally, the Final Rule requires that financial institutions file a suspicious activity report if they suspect that a customer is processing illegal transactions through their facilities.

Under the Final Rule, participants will not be liable for blocking a transaction if they reasonably believed the transaction was restricted, or if the transaction was blocked pursuant to the policies and procedures implemented by the participant as part of its compliance with the regulation.

Somewhat unhelpfully, the Final Rule does not list businesses known to be involved in unlawful internet gambling. Nor does it clearly define "unlawful gambling." It does, however, clearly define "restricted transaction" to include only those funds going to an internet gambling business, and not funds going to gamblers.

## II. Implications for Non-U.S. Participants

Non-U.S. financial institutions are affected by the Final Rule to the extent that they have "U.S. offices in a designated payment system." The responsibility for establishing and implementing the required policies and procedures falls only on U.S. participants. Thus, while non-U.S. financial institutions will not be subject to the Final Rule, their U.S. affiliates or subsidiaries will be. Moreover, the Final Rule may have an indirect effect on non-U.S. financial institutions, since participants may not knowingly process U.S. related payments in furtherance of unlawful internet gambling. Additionally, if non-U.S. financial institutions do not independently maintain some blocking mechanism, they risk notification to U.S. authorities that they may be processing restricted payments.

Because there is no practical way for a U.S. institution to prevent its consumer customers from sending a restricted transaction to a non-U.S. counterparty, the Final Rule exempts such transactions (e.g., ACH credits and wire transfers). Rather, it contains model policies and procedures only for cross-border debit transactions (e.g. ACH debits and check collections) and cross-border transactions in card systems.

U.S. participants are deemed to be in compliance with the Final Rule as long as they have policies and procedures to address non-U.S. participants with actual knowledge that a restricted transaction is being processed. Actual knowledge is defined narrowly,[6] thus minimizing the possibility that U.S. participants will be held liable for the conduct of their non-U.S. counterparties. Similarly, for check collection systems, depository banks that receive checks from foreign banks are considered in compliance with the Final Rule if the depository banks have policies and procedures to identify and block those transactions that the bank has actual knowledge are restricted transactions.

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[3] On May 20, 2010, the Office of the Comptroller of the Currency issued guidance for reviewing compliance with the UIGEA. This guidance can be found at: http://www.occ.treas.gov/ftp/bulletin/2010-17a.pdf.

[4] Section 2(y) defines "restricted transactions" as those transactions involving credit, funds, instruments or proceeds that persons involved in the business of betting or wagering are prohibited from accepting in connection with the participation of another person in unlawful internet gambling.

[5] Certain types of U.S. participants are exempt from the Final Rule, including those who are processing outbound cross-border credit transactions, as well as send agents in a money transmitting business. Non-exempt participants include, but are not limited to, companies, individuals, and card systems that maintain or establish a relationship with an internet gambling company.

[6] Under Section 2(a) "actual knowledge" means a particular fact with respect to a transaction or commercial customer that is known by, or brought to the attention of an individual in the organization responsible for the organization's compliance function with respect to that transaction or commercial customer, or an officer of the organization.

Finally, if a U.S. participant is notified that it has been sent a cross-border restricted transaction by a particular foreign respondent, then the U.S. participant must notify the respondent of the restricted transaction. A model notice is included in the appendix to the Final Rule.

## III. Enforcement and Legislative Trends

It is expected that U.S. authorities will continue to focus on online gambling companies with U.S.-facing business as prosecution targets. Currently, U.S. authorities are also focusing on payment processors as both targets of prosecution and potential witnesses. Some industry insiders believe that the next trend in enforcement actions will involve U.S. authorities prosecuting individual online gamers or service providers or advisors that are deemed to have aided and abetted unlawful internet gambling. Many believe the enforcement environment will be shaped in the months following the implementation of the Final Rule, depending on how effective the Final Rule is in detecting and eliminating unlawful internet gambling in the United States.

Proponents of online gambling had hoped that the delay in implementation of the Final Rule would give Congress the opportunity to enact legislation that would reverse or substantially lessen UIGEA's regulatory impact. Currently, there are three pieces of legislation pending in Congress that would amend UIGEA, including a tax bill aimed at collecting tax revenue from online gambling companies. These bills, however, are currently politically unpopular, and are estimated to only have an 18% chance of being passed by the House of Representatives and a 3% chance of being passed by the Senate.

## IV. The Solution and Developing Market Practice

In response to the long-anticipated Final Rule and the extra-territorial reach of U.S. criminal laws, many non-U.S. financial institutions have already implemented processes and procedures to identify and block any payments relating to online gambling to or from the United States. These policies and procedures may leverage existing client due diligence and account monitoring activity performed in connection with anti-money laundering and economic sanctions risk-management activities. Such procedures could include, among other things: (i) identifying customers that are involved in online gambling; (ii) requesting attestations from those clients of their compliance with U.S. laws; and (iii) monitoring client accounts for restricted transactions. Proactive compliance with the United States' anti-gambling laws will help beat the odds now running against on-line gaming companies.