News from the Chair

by Jeffrey I. Langer
Dreher Langer & Tomkies L.L.P.

This is my last report to you as Consumer Financial Services Committee Chair. My three-year term expires at the end of the upcoming Annual Meeting. There is exciting news below on my successor and other new and continuing Committee leaders. It has been an honor, a privilege and a pleasure (most of the time!) to serve as Chair of this wonderful Committee. I want to thank everyone who has served as a CFSC leader during my term for their dedication and hard work. The CFSC could not function without the talents and creativity of the entire leadership, as well as the contributions of so many of our members.

This is my last report to you as Consumer Financial Services Committee Chair. My three-year term expires at the end of the upcoming Annual Meeting. There is exciting news below on my successor and other new and continuing Committee leaders. It has been an honor, a privilege and a pleasure (most of the time!) to serve as Chair of this wonderful Committee. I want to thank everyone who has served as a CFSC leader during my term for their dedication and hard work. The CFSC could not function without the talents and creativity of the entire leadership, as well as the contributions of so many of our members.

Although any attempt to express my special thanks to those CFSC members who particularly helped me to become, and to discharge my responsibilities as, the Chair no doubt will exclude some who deserve recognition, I nonetheless will attempt to do so. First, my immediate predecessors, Lynne Barr and Amy Bizar, impressed upon me both by example and through their guidance the critical role that the Chair exercises in establishing the nature and tone of the Committee’s meetings, programs, publications, projects and social activities and the importance of being a benevolent yet demanding leader and grooming future leaders. Second, former Chairs Roland Brandel, Bob Chamness and Alan Kaplinsky offered wise and thoughtful advice whenever I sought their counsel. Roland’s encyclopedic knowledge of the Business Law Section and the ABA helped me navigate the many challenges that a Committee Chair faces. Third, I cannot sufficiently express my gratitude to my Committee Vice-Chairs, Stan Mabbutt (with whom I served as a Co-Vice-Chair under Lynne and who was an invaluable resource to, and did the “dirty work” for, me during my first year as Chair), Margie Corwin (who has served in this position with great distinction and grace and during my entire term), Don Lampe (who has offered many new ideas and challenged me to implement many changes and new initiatives during his two years in this position) and Joan Warrington (who has moved seamlessly during the past year from her excellent work as Chair of the Privacy Subcommittee and Co-Chair of the Joint Privacy Task Force into a key role in recommending and developing programming). The job of CFSC Chair has become much too complex and time-consuming to handle without having skilled, hard-working Vice-Chairs to assume many of the Chair’s responsibilities. It has been a great comfort to know that I could rely on these four fabulous people and lawyers whenever I needed their help.

Finally, I want to recognize several of my Subcommittee leaders and Vice-Chairs. Programs Subcommittee leaders Barry Abbott, Rick Fischer and Nikki Munro have recommended and helped plan the first-rate Programs and Committee Forums held at, and collected and organized the subcommittee meeting agendas and materials for, our meetings. Membership Subcommittee leaders Julie Caggiano and Joe Looney have greatly expanded CFSC membership services (such as integrating new members and first-time meeting attendees into Committee activities and expanding opportunities to socialize and recruitment efforts (through our in-house counsel and minority lawyer initiatives). Long Range Planning Subcommittee leaders Robert Cook and Forrest Stanley have analyzed and recommended changes to our Committee and subcommittee structure and reorientation of our substantive focus to concentrate more on developing areas of consumer financial services law. I have adopted a number of their recommendations. Publications and Communications Subcommittee Chair Alvin Harrell has continued to perform yeoman service as the Editor of the Annual Survey of CFSLaw in The Business Lawyer, and Vice-Chair Rick Eckman, with the help of Managing Editor Jackie Parker, created the format of and has served
In addition, John Ropiequet, CFSC Liaison to the Section Pro Bono Committee, has helped formulate, and oversee the implementation of, our financial literacy education pro bono projects, including the (i) expansion and updating of our www.Safeborrowing.com website, (ii) creation (by Rhonda Daniels) of a volunteer speaker's bureau to teach 45-90 minute financial literacy classes in high schools under curricula she selected and (iii) preparation (by Elena Lovoy) of materials on consumer and small business debt deferment for the Section's Hurricane Katrina and Rita Relief website. This work is continuing. Last, but not least, Internet Delivery/Electronic Banking Subcommittee leaders Rick Hackett and Roberta Torian have developed a productive working relationship with the leaders of the Cyberspace Law Committee's Electronic Financial Services Subcommittee and the Banking Law Committee's Payments and Electronic Commerce Subcommittee. The CFSC, CLC and BLC have co-sponsored several Programs on financial services technology issues such as stored value cards and information security at recent Spring and Annual Meetings.

CFSC Leadership Changes

I am delighted to announce the following changes in the CFSC leadership that will take effect at the end of the upcoming Annual Meeting. I announced these changes at the Spring Meeting, but most of you were unable to attend the meeting. I know that you join me in thanking all outgoing leaders for their outstanding service and wishing all incoming leaders success in their new positions.

1. Committee Chair. Based on the approval of my recommendation, Don Lamp will become the CFSC Chair. Don has the experience, vision, ideas and energy to take the Committee to the next level. As noted above, for the past two years Don has been a CFSC Vice-Chair, and I know that he will do a superb job as Chair. I discussed the Chair position first with the senior CFSC Vice-Chair, Margie Corwin, and she declined the position. Under the Committee leadership succession plan, Don was next in line to become the Chair, and he enthusiastically agreed to take the position. I greatly appreciate Margie's tremendous dedication and commitment to her Vice-Chair responsibilities and wonderful service to the CFSC.

2. Committee Vice-Chairs. Margie and Joan Warrington have agreed to remain as CFSC VCs for at least one more year (2006-07). Their experience and insight will be invaluable to Don.

3. Federal and State Trade Practices Subcommittee. Current VC Andrew Smith will become the Chair, replacing Jean Noonan. Susan Lau and Bob McKew will become the co-VCs.

4. Internet Delivery/Electronic Banking Subcommittee. Current VC Roberta Torian will become the Chair, replacing Rick Hackett. Russ Schrader will become the VC.

5. Litigation and Arbitration Subcommittee. Current VC Steve Harvey will become the Chair, replacing Nina Simon. Craig Varga will become the VC.

6. Long Range Planning Subcommittee. Nessa Feddis and Jeremy Rosenblum will become the Chair and Vice-Chair, respectively, replacing Chair Robert Cook and VC Forrest Stanley.

7. Publications/Communications Subcommittee. Current VC Rick Eckman will become the Chair, replacing Alvin Harrell. David Beam (Kirkpatrick & Lockhart firm) will become the VC.
Annual Meeting Schedule

See the linked CFSC Annual Meeting schedule. The CFSC will meet on Sunday, August 6 (7:30 a.m.-12:00 noon; Leadership meeting 12 noon-1:00 p.m.) and Monday, August 7 (7:00 a.m.-1:00 p.m.). Due to limited meeting space and times, only eight (8) of the 12 CFSC substantive subcommittees will be meeting. Also, we will be sponsoring only one program, “You Had a Security Breach, What Do You Have to Do and What Happens Next?” The CFSC hotel is the Waikiki Beach Marriott Resort & Spa. There will be no Committee Dinner, but there will be a CFSC Reception on Sunday, August 5 from 5 to 7 p.m. at the Marriott. You must pick up your registration materials (or register onsite) at the Hawaii Convention Center (there will be shuttle buses); there will be no Satellite Registration available at the Marriott. Here are the relevant registration hours at the Convention Center:

<table>
<thead>
<tr>
<th>Date</th>
<th>Hours</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wednesday, Aug 2</td>
<td>12:00 p.m. to 6:00 p.m.</td>
</tr>
<tr>
<td>Thursday, Aug 3</td>
<td>7:00 a.m. to 7:00 p.m.</td>
</tr>
<tr>
<td>Friday, Aug 4</td>
<td>7:00 a.m. to 7:00 p.m.</td>
</tr>
<tr>
<td>Saturday, Aug 5</td>
<td>7:00 a.m. to 6:00 p.m.</td>
</tr>
<tr>
<td>Sunday, Aug 6</td>
<td>7:00 a.m. to 3:00 p.m.</td>
</tr>
<tr>
<td>Monday, Aug 7</td>
<td>7:00 a.m. to 1:00 p.m.</td>
</tr>
</tbody>
</table>

Also, an exclusive reception for BLS members will be held in the exhibit hall on Thursday, August 3 from 5:00 p.m. to 7:00 p.m.

Registration will be open during the reception. And, the Section reception at the Marriott will be held on Friday, August 4 from 5 to 7 p.m.

2007 CFSC Winter Meeting Dates and Hotel

The CFSC will hold its 2007 Winter Meeting from Saturday evening, January 6 (starting with a Welcome Reception) through Tuesday morning, January 9, 2007 (ending around 11:00 a.m.) at the four-star Laguna Cliffs Marriott Resort & Spa (www.lagunacliffs.com) in Dana Point, California, south of Laguna Beach and Newport Beach and about a 30-minute drive from the John Wayne Orange County Airport. The daily room rate will be $189, an excellent value. This will be our first Winter Meeting in Orange County and Don's first meeting as CFSC Chair.

2006 Spring Section Meeting

We had another excellent set of CFSC meetings and sponsored or co-sponsored Programs and Committee Forums April 6-8 in Tampa. Materials from all Spring Meeting Programs/Forums are available on the Section (BLS) website, www.ababusinesslaw.org. To access the CFSC website, please refer to the linked CFSC and ABA Website Access Directions.

2006 Annual Survey of Consumer Financial Services Law in The Business Lawyer

The Annual Survey appears in the February 2006 issue of The Business Lawyer, which was issued in mid-June. The Survey is the premier annual survey of consumer financial services law, and I hope that you find it interesting and useful. Please contact Don Lampe (dlampe@wcsr.com) or Survey Editor Alvin Harrell (aharrell@okcu.edu) with any comments or suggestions on the content or style of the Survey. The Committee has had to reduce the length of the Survey substantially in the past two years due to printing and other costs for TBL. We are striving to continue to make the Survey as comprehensive and relevant as possible by covering the most important developments in the areas on which our substantive subcommittees and the Compliance Management Subcommittee...
focus. The articles for the 2007 Survey are in process, and they will be published in the February 2007 issue of TBL.

Task Force Report, Consumer Perspective and Response on Joint CFSC and Cyberspace Law Committee Home Banking Services Agreement

Finally, the February 2006 issue of TBL also includes three articles addressing the Home Banking Services Agreement and Commentary developed by a Joint Task Force of the Consumer Financial Services and Cyberspace Law Committees under CFSC member John Lee’s direction. I commend this outstanding collection of articles to you.

Jeffrey I Langer
Dreher Langer & Tomkies L.L.P.
Chair,
Consumer Financial Services Committee
ABA Section of Business Law

Updates

Preemption and Federalism Subcommittee Update

Michael C. Tomkies, Dreher Langer & Tomkies L.L.P.

At the Spring Meeting in Tampa, Florida, the Preemption and Federalism Subcommittee was pleased to host three excellent speakers to discuss recent preemption developments, particularly those impacting federally insured state-chartered banks. Following up on the remarks of Bob Fick (FDIC) at the Winter Meeting in Utah, Joe DiNuzzo from the FDIC discussed the comments received to date on the FDIC’s proposed preemption rulemaking and the staff’s continuing consideration of issues despite the lack of a confirmed chairman to replace former Chairman Donald E. Powell who resigned on November 15, 2005. (Sheila C. Bair was confirmed in June 2006 as the 19th Chairman of the Federal Deposit Insurance Corporation, so further word on the FDIC’s proposed rule may be forthcoming.) Professor Vincent DiLorenzo of St. John’s University School of Law responded to Joe DiNuzzo’s remarks and discussed the broader context of the preemption debate, focusing in particular on the role of the judiciary, as distinct from the regulatory agencies, in making preemption determinations, from a more academic perspective. Jeremy Rosenblum then offered reactions from an industry perspective and some insight into the status of one federally insured state-chartered bank preemption case, BankWest v. Baker, then before the Eleventh Circuit, as counsel for the banks in that case.

More...

Featured Articles

The New ABA Model Deposit Account Control Agreement
Edwin E. Smith, Bingham McCutcheon LLP

After two years of preparation, the Joint Task Force on Deposit Account Control Agreements unveiled its new form of deposit account control agreement at a program held on Friday, April 7, 2006, at the Section’s Spring Meeting in Tampa, Florida.

The revised Article 9 of the Uniform Commercial Code, which is now in
effect in all states and the District of Columbia, brought within its scope security interests in bank deposit accounts as original collateral in commercial transactions. The only method by which a security interest in a deposit account as original collateral may be perfected, though, is by “control” as defined in UCC § 9-104(a). And one common form in which control is obtained is for the secured party to enter into a so-called “control agreement” with the depositary bank and the debtor by which the depositary bank agrees to follow instructions as to the funds in the deposit account without the debtor’s further consent.

More...

Morality Enforcement Through Payment Systems Regulation: Overview of Federal Framework for Payment Systems Regulation and Enforcement and Industry Reaction

I. Introduction.

A. Efforts continue to occur at the federal level to create a framework for payment systems regulation and enforcement of online transactions viewed by the proponents as undesirable.

B. This outline reviews federal developments relating to efforts to use the payment systems to enforce laws regarding unlawful Internet gambling, Internet pharmacies and Internet child pornography, and the steps the payment industry has taken, and is taking, to address concerns in these areas.

More...
Preemption and Federalism Subcommittee Update
by Michael C. Tomkies
Dreher Langer & Tomkies L.L.P.

At the Spring Meeting in Tampa, Florida, the Preemption and Federalism Subcommittee was pleased to host three excellent speakers to discuss recent preemption developments, particularly those impacting federally insured state-chartered banks. Following up on the remarks of Bob Fick (FDIC) at the Winter Meeting in Utah, Joe DiNuzzo from the FDIC discussed the comments received to date on the FDIC’s proposed preemption rulemaking and the staff’s continuing consideration of issues despite the lack of a confirmed chairman to replace former Chairman Donald E. Powell who resigned on November 15, 2005. (Sheila C. Bair was confirmed in June 2006 as the 19th Chairman of the Federal Deposit Insurance Corporation, so further word on the FDIC’s proposed rule may be forthcoming.) Professor Vincent DiLorenzo of St. John's University School of Law responded to Joe DiNuzzo’s remarks and discussed the broader context of the preemption debate, focusing in particular on the role of the judiciary, as distinct from the regulatory agencies, in making preemption determinations, from a more academic perspective. Jeremy Rosenblum then offered reactions from an industry perspective and some insight into the status of one federally insured state-chartered bank preemption case, BankWest v. Baker, then before the Eleventh Circuit, as counsel for the banks in that case. See BankWest v. Baker, Case No. 04-12420, 2006 WL 1112910 (11th Cir. April 28, 2006).

The original action in BankWest v. Baker was brought by out-of-state federally insured banks to prevent enforcement of the provision of the Georgia Payday Loan law that restricts a payday loan store from acting as an agent for an out-of-state bank when the agreement grants the in-state agent “the predominate economic interest” in the bank’s payday loan. The district court denied the banks’ motions for a preliminary injunction against enforcement of the Georgia Payday Loan law and the Eleventh Circuit affirmed the district court’s decision. On December 28, 2005, the Eleventh Circuit granted appellants’ petition for rehearing en banc and vacated the prior panel decision. Subsequently, on April 28, 2006, the Eleventh Circuit Court of Appeals vacated its prior opinion in BankWest, 411 F.3d 1289 (11th Cir. 2005), and the opinion of the lower court, 324 F. Supp. 2d 1333, and dismissed a pending appeal as moot. See BankWest v. Baker, Case No. 04-12420, 2006 WL 1112910 (11th Cir. April 28, 2006).

On March 15, 2006, while the case was being briefed at the en banc stage, the state filed a suggestion of mootness. The state argued that, as a result of regulatory activities of the FDIC, the banks are no longer pursuing the short-term loan program and servicing agreements that were the subject of the preliminary injunction motions and appeal. The Eleventh Circuit agreed with the state that the present appeal from the preliminary injunction ruling no longer presents a justiciable controversy within the meaning of Article III of the Constitution based on recent developments and significant change in factual circumstances. The court concluded that the payday loan programs that gave rise to the preliminary injunction ruling are no longer being used by any of the banks.

The banks argued that the appeal was not moot with respect to loans already made. The court, however, found that there never was any controversy in the appeal about whether
the Georgia Payday Loan law could be applied to uncollected loans that were made before the law’s effective date. The banks also argued that the appeal was not moot because they intend to develop, or are in the process of developing, new consumer loan programs, and the presence of the law interferes with their ability to develop new loan products. The court disagreed, finding that the fact that some banks may be retooling their business plans, may develop another type of short-term loan, and may enter into new servicing agreements with the non-bank parties in Georgia does not keep the appeal from being moot because the precise nature of the new but different loan programs and the manner in which they are to be administered in Georgia remain far too speculative and abstract at this juncture to create an actual case or controversy.

The court concluded that the district court’s denial of the motion for a preliminary injunction—the only ruling at issue in the appeal—was moot, and this conclusion compelled the court to dismiss the appeal and to vacate the prior opinions.

Materials:

- “Preemption of State Law for State banks,” by Robert C. Fick, Esq., FDIC
  (PowerPoint presentation)
  ![fick.ppt]

  ![dilorenzo.pdf]

- Three letters from Jeremy T. Rosenblum, Esq., to Robert F. Feldman, Executive Secretary, FDIC, on the FDIC’s proposed preemption rule.
Using the New ABA Model Deposit Account Control Agreement
by Edwin E. Smith
Bingham McCutcheon LLP

After two years of preparation, the Joint Task Force on Deposit Account Control Agreements unveiled its new form of deposit account control agreement at a program held on Friday, April 7, 2006, at the Section’s Spring Meeting in Tampa, Florida.

The revised Article 9 of the Uniform Commercial Code, which is now in effect in all states and the District of Columbia, brought within its scope security interests in bank deposit accounts as original collateral in commercial transactions. The only method by which a security interest in a deposit account as original collateral may be perfected, though, is by “control” as defined in UCC § 9-104(a). And one common form in which control is obtained is for the secured party to enter into a so-called “control agreement” with the depositary bank and the debtor by which the depositary bank agrees to follow instructions as to the funds in the deposit account without the debtor’s further consent.

In practice, the negotiation of control agreements has been tedious. Banks and institutional secured parties have their own forms with differing goals in mind. Banks offer to enter into control agreements as accommodations to their customers and are interested in minimizing risk. Secured parties seek to maximize practical control over cash balances in deposit accounts. The result has been a classic “battle of the forms”.

To create some order out of this chaos, the Section in 2004 formed a joint task force of the Banking Law, Commercial Financial Services, Consumer Financial Services and Uniform Commercial Code Committees to develop a form of deposit account control agreement that would seek to address the competing concerns of all parties and which could be agreed to with minimal negotiation. The task force, under the leadership of its co-chairs, Marshall Grodner, Marvin Heileson, John Pickering, Roberta Torian and Ed Smith, and with Ed Smith acting as the reporter, met over a two-year period at Spring and Annual Meetings of the Section and at numerous all-day standalone meetings to develop the form that was presented at the program.

The panelists consisted of Marshall Grodner, Cris Kako, Roberta Torian, Ed Smith and Barbara Yadley - all members of the task force - and went through a script by which Ed purported to be trying to learn the form to advise a secured lending client and Marshall, Cris, Roberta and Barbara responded to Ed’s questions. The scene played out in the context of a debtor obtaining financing from a secured party and granting to the secured party a security interest in a deposit account against which, absent instructions from the secured party to the contrary, the debtor writes checks and sends payment instructions. The discussion focused upon, among other things the structure of the form as two documents (a deposit account control agreement and a set of general terms incorporated by reference into the deposit account control agreement), the circumstances under which the depositary bank was obligated under the form to act on the secured
party’s instructions, exculpation and indemnification of the depositary bank, third party claims to the deposit account, assignment and termination of the control agreement, choice of law and opinion issues.

The task force’s work will continue. The task force is developing inserts to the form to deal with standing instructions to sweep cash balances to the secured party, lock box arrangements, omnibus investment sweeps, time deposits, first and second lien arrangements and securitizations.

The task force’s report, the two-document form and the inserts (both final and draft) may be obtained from the task force web site at:

http://www.abanet.org/dch/committee.cfm?com=CL710060
I. Introduction.

A. Efforts continue to occur at the federal level to create a framework for payment systems regulation and enforcement of online transactions viewed by the proponents as undesirable.

B. This outline reviews federal developments relating to efforts to use the payment systems to enforce laws regarding unlawful Internet gambling, Internet pharmacies and Internet child pornography, and the steps the payment industry has taken, and is taking, to address concerns in these areas.

II. Federal Internet Gambling Initiatives.

A. Background.

1. Internet gambling presents unique challenges for both law enforcement and payment systems.

2. Internet gambling can be conducted entirely over the Internet and there is no need to exchange cash or illicit goods.

3. Internet gambling operations typically are located offshore where Internet gambling may be legal and beyond the reach of U.S. law enforcement agencies, which makes it uniquely difficult to detect or control.

4. Legislation to deter unlawful Internet gambling has been introduced in each Congress for almost a decade.

5. Also, in response to U.S. efforts to curtail Internet gambling, complaints have been filed by certain countries (specifically Antigua and Barbuda) with the World Trade Organization (“WTO”), alleging that the U.S. is required to allow foreign gambling operators to compete with domestic operators.

B. Federal Legislation.
1. On November 18, 2005, Representative Leach (R-IA) introduced H.R. 4411, the “Unlawful Internet Gambling Enforcement Act of 2005.”

   a. The legislation defines “unlawful Internet gambling” as the “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.”

   b. The legislation further provides that “[n]o person engaged in the business of betting or wagering may knowingly accept, in connection with the participation of another person in unlawful Internet gambling:”

      (1) Credit or the proceeds of credit, including credit extended through credit cards;

      (2) An electronic fund transfer;

      (3) Any check, draft or similar instrument; or

      (4) The proceeds of any other financial transaction prescribed by regulation.

   c. The legislation provides an exemption for certain intrastate transactions if:

      (1) The bet or wager is initiated and received or otherwise made exclusively within a single state;

      (2) The bet or wager and the method by which the bet or wager is initiated and received or otherwise made is expressly authorized by, and placed in accordance with, state law and such state law or regulations include:

         (a) Age and location verification requirements designed to block access to minors and out-of-state persons; and

         (b) Appropriate data security standards to prevent unauthorized access by persons whose age and location has not been verified in accordance with state law or regulations; and
The bet or wager does not violate any provision of the

(i) Interstate Horseracing Act;

(ii) Professional and Amateur Sports Protection Act;

(iii) Gambling Devices Transportation Act; or

(iv) Indian Gaming Regulatory Act.

d. The legislation also includes certain exceptions for intratribal transactions and interstate horseracing.

e. In addition, the legislation would require the Secretary of the Treasury (“Secretary”), in consultation with the Board of Governors of the Federal Reserve System (“FRB”) and the Attorney General, to prescribe regulations requiring payment systems and their participants to establish policies and procedures to prevent restricted transactions in any of the following ways:

(1) Establishment of procedures that:

(a) Allow the payment system and person involved in the system to identify restricted transactions by codes in authorization messages; and

(b) Block restricted transactions identified through these policies and procedures.

(2) Such regulations would:

(a) Identify types of policies and procedures (including nonexclusive examples) deemed to be reasonably designed to identify and block or prevent acceptance of products or services regarding each type of restricted transaction;

(b) To the extent practical, allow any participant in a payment system to choose among alternative means of identifying and blocking or otherwise preventing acceptance
of products or services in connection with restricted transactions; and

(c) Consider exempting restricted transactions from regulatory requirements if the Secretary finds that “it is not reasonably practical to identify and block, or otherwise prevent, such transactions.”

(3) A financial transaction provider would be deemed to be in compliance with the regulations if:

(a) The person relies on and complies with policies and procedures of a designated payment system of which it is a member or participant to:

(i) Identify and block restricted transactions; or

(ii) Otherwise prevent acceptance of products or services of the payment system, member or participant in connection with restricted transactions; and

(b) The policies and procedures of the payment system comply with the regulations issued by the Secretary.

f. The legislation also would provide a safe harbor for persons (such as a credit card issuer or processor) blocking or refusing to honor restricted transactions or relying on the policies and procedures of the payment system in an effort to comply with the regulations.

g. Regulatory enforcement would be carried out by the federal functional regulators and the Federal Trade Commission (“FTC”) in the manner provided in the Gramm-Leach-Bliley Act (“GLBA”). Under the GLBA, the federal functional regulator is:

(1) The Office of the Comptroller of the Currency for national banks, federal branches and agencies of foreign banks and any subsidiaries (except brokers, dealers, persons providing insurance, investment companies and investment advisers).
(2) The FRB for member banks (other than national banks), branches and agencies of foreign banks (other than federal branches, federal agencies and insured state branches of foreign banks), commercial lending companies owned or controlled by foreign banks, organizations operating under section 25 or 25A of the Federal Reserve Act and bank holding companies and their nonbank subsidiaries or affiliates (except brokers, dealers, persons providing insurance, investment companies and investment advisers).

(3) The Federal Deposit Insurance Corporation (“FDIC”) for banks insured by the FDIC (other than FRB members), insured state branches of foreign banks and any subsidiaries thereof (except brokers, dealers, persons providing insurance, investment companies and investment advisers).

(4) The Office of Thrift Supervision for savings associations insured by the FDIC and their subsidiaries (except brokers, dealers, persons providing insurance, investment companies and investment advisers).

(5) The National Credit Union Administration for federally insured credit unions and their subsidiaries.

h. The legislation also would provide civil and criminal penalties.

2. Senator Kyl (R-AZ) is expected to pursue similar legislation on the Senate side, as he has in past sessions of Congress.

a. Senator Kyl also attempted to add language to prevent the use of certain payment instruments, credit cards and fund transfers for unlawful Internet gambling to H.R. 2862, the Commerce-Justice-Science appropriations bill.

b. The measure was blocked on September 15, 2005, when a point of order was raised.

C. WTO Proceeding.

1. As a result of U.S. efforts to curtail Internet gambling, the countries of Antigua and Barbuda filed a complaint with the WTO
against the U.S. alleging that the U.S. is required to allow foreign gambling operators to compete with domestic operators.

2. In November 2004, the WTO issued an interim ruling, which stated that gambling is covered under the General Agreement on Trade in Services (“GATS”) and that state and federal gambling restrictions violate the U.S. GATS commitment. On January 7, 2005, the U.S. submitted an appeal.

3. In April 2005, the WTO appeals panel reversed in part its decision. Although the panel acknowledged that some of the U.S. federal and state prohibitions on cross-border gambling were valid, it recommended that the U.S. bring its cross-border gambling practices into conformity with its obligations under GATS.

4. According to the panel, the U.S. must comply with the WTO ruling by April 3, 2006.

D. Industry Reaction to Unlawful Internet Gambling.

1. Payment card issuers have no interest in having their cards used for illegal transactions.

   a. For example, Visa prohibits the use of Visa branded payment cards for illegal transactions of any kind.

   b. Unlawful Internet gambling transactions have led to extensive and costly litigation over whether participating cardholders are liable for charges to their accounts, even when the cardholders do not dispute that they actually participated in the gambling transactions.

   c. Unlawful Internet gambling transactions often generate severe customer relationship problems with cardholders who otherwise might be model customers.

   d. Repayment problems resulting from unlawful Internet gambling transactions can adversely affect the ability of cardholders to meet their account obligations generally, including those relating to legal, non-gambling transactions.

   e. Unlawful Internet gambling transactions create credit risks for financial institutions that extend far beyond the illegal transactions themselves, as well as reputational risks and regulatory responses harmful to both the financial institutions and the payment systems.
f. Costs to the payment card industry in the U.S. of unlawful Internet gambling transactions far exceed any benefits that could possibly be gained by the marginal additional transaction volume due to such transactions.

2. Both payment card issuers and the payment card associations have taken various steps to address the use of credit cards and debit cards for unlawful gambling.

a. For example, Visa requires gaming merchants that accept association branded cards to use a combination of “gaming” merchant category and electronic commerce indicator codes for all Internet gambling transactions when they request authorizations from card issuers for payment card transactions.

(1) The codes are transmitted through the Visa network as part of the authorization message.

(2) The combination of codes informs the card issuer that the transaction is likely to be an Internet gambling transaction, thus enabling the issuer to deny authorization for (or block) such transactions.

(3) Many, if not most, card issuers already have taken advantage of this blocking capability, as well as other tools they have devised to deny authorization for any transaction coded as an Internet gambling transaction.

III. Federal Internet Pharmacy Initiatives.

A. Background.

1. Numerous Web sites sell a variety of drugs online, and these Web sites may or may not require the consumer to obtain a valid prescription in the state where the consumer resides in order to purchase those drugs.

2. In 2004, the General Accounting Office (now called the Government Accountability Office) issued a report on Internet pharmacies, “Internet Pharmacies: Some Pose Safety Risks for Consumers,” which highlighted that the process for obtaining a drug from many of the pharmacies surveyed “involved only selecting the desired medication and submitting the necessary billing and shipping information.”
3. Proposed legislation has been introduced to address concerns regarding the sale of illegal prescription drugs over the Internet, which include, in some bills, imposing new requirements on payment systems.

**B. Examples of Federal Legislation.**

1. On January 26, 2005, Senator Gregg (R-NH) introduced S. 184, the “Safe IMPORT Act of 2005.” Similar legislation (H.R. 753) was introduced in the House by Representative Bradley (R-NH) on February 10, 2005.

   a. The legislation would impose certain requirements on a “person” using a designated payment system, which includes:

      (1) A creditor;

      (2) A credit card issuer;

      (3) A financial institution;

      (4) An operator of a terminal at which an electronic fund transfer may be initiated; or

      (5) An international, national, regional or local network used to effect a credit transaction, electronic fund transfer or money transmitting business, or any participant in such network.

   b. The legislation would require the federal functional regulators to promulgate regulations to require such persons to prevent restricted transactions by establishing policies and procedures reasonably designed to allow the payment system and any person involved in the system to identify restricted transactions by means of codes in authorization messages or by other means and:

      (1) Are reasonably designed to block restricted transactions identified under such policies and procedures; or

      (2) Prevent the acceptance of the payment system’s products or services in connection with a restricted transaction.

      (3) Such regulations would:
(a) Identify types of policies and procedures (including nonexclusive examples) deemed to be reasonably designed to identify and block or prevent acceptance of products or services in connection with each type of restricted transaction, including:

(i) Identifying transactions by a code or codes in the authorization message; and

(ii) Denying authorization of a credit card transaction in response to an authorization message; and

(b) To the extent practicable, permit any participant in a designated payment system to choose among alternative means of identifying and blocking or otherwise preventing acceptance of payment system products or services in connection with restricted transactions.

(4) A person would be deemed to be in compliance with the regulations if:

(a) The person relies on, and complies with, the policies and procedures of a designated payment system of which it is a member or participant to:

(i) Identify and block restricted transactions; or

(ii) Otherwise prevent acceptance of products or services of the payment system, member or participant in connection with restricted transactions; and

(b) The policies and procedures of the designated payment system comply with the regulations.

(5) The legislation would provide a safe harbor to persons for blocking or refusing to honor restricted transactions, or as a member of a designated payment system, relying on the policies or
procedures of the payment system to comply with the regulations.

c. These requirements would be enforced by the federal functional regulators and the FTC under applicable law in the manner provided under the GLBA.

2. On April 21, 2005, Representative Walden (R-OR) introduced H.R. 1808, the “Safe Online Drug Act of 2005.”

a. The legislation would require the federal functional regulators to prescribe regulations to require any designated payment system to establish policies and procedures reasonably designed to identify and prevent restricted transactions in any of the following ways:

(1) Establish policies and procedures that:

   (a) Allow the payment system and any person involved in the system to identify restricted transactions by means of codes in authorization messages or by other means; and

   (b) Block restricted transactions identified as a result of the policies and procedures.

(2) Establishment of policies and procedures that prevent the acceptance of products or services of the payment system in connection with a restricted transaction.

b. Such regulations would:

(1) Identify types of policies and procedures (including nonexclusive examples), which would be deemed to be reasonably designed to identify and block or prevent the acceptance of products or services with respect to each type of transaction. For example, if credit card transactions are so designated:

   (a) Identifying transactions by a code or codes in the authorization message; and

   (b) Denying authorization of a credit card transaction in response to an authorization message.
To the extent practicable, permit any participant in a payment system to choose among alternative means of identifying and blocking or otherwise preventing acceptance of payment system products or services in connection with restricted transactions; and

Consider exempting restricted transactions if the federal functional regulators find that it is not reasonably practical to identify and block or otherwise prevent such transactions.

c. A creditor, credit card issuer, financial institution, operator of a terminal at which an electronic fund transfer may be initiated, money transmitting business, or international, national, regional or local network used to effect a credit transaction, electronic fund transfer or money transmitting services, or a participant in such a network, would be deemed in compliance with the regulations if:

(a) Such person relies on, and complies with, the policies and procedures of a designated payment system of which it is a member or participant to:

(i) Identify and block restricted transactions; or

(ii) Otherwise prevent acceptance of products or services of the payment system, member or participant in connection with restricted transactions; and

(b) The policies and procedures of the designated payment system comply with the regulations.

d. These requirements would be enforced by the federal functional regulators and the FTC under applicable law in the manner provided in the GLBA.

C. Industry Response to Online Pharmacy Concerns.

1. On December 13, 2005, the Subcommittee on Oversight and Investigations of the House Energy and Commerce Committee held a hearing on the “Safety of Imported Pharmaceuticals: Strengthening Efforts to Combat the Sales of Controlled Substances Over the Internet.”
2. Visa presented testimony before the Subcommittee, which outlined Visa’s efforts to respond to the challenges posed by Internet transactions.

3. Visa has met with representatives of the Drug Enforcement Agency (“DEA”) and the Food and Drug Administration (“FDA”) to discuss approaches to the problem of illicit transactions with Internet pharmacies and has alerted its member financial institutions to the problem of illicit activities by Internet pharmacies.

   a. Visa reminded its member financial institutions of their responsibilities to ensure that only legal transactions enter the Visa payment system and directed their attention to the lists of controlled substances and problematic drugs maintained at the FDA and DEA Web sites, as well as in safety bulletins on the FDA Web site.

   b. Visa noted that a safe Web site should be licensed by the state board of pharmacy where the Web site is operating, have a licensed pharmacist available to answer questions, require a prescription from a U.S. licensed doctor or other licensed professional to write prescriptions, and provide a way to speak to a person about problems.

4. Visa also has retained the services of an outside firm to search the Internet for Web sites selling controlled substances and accepting Visa payment cards.

   a. Using the firm, Visa has initiated a program of monitoring the Internet to ensure that Visa payment services are not used for the sale of Schedule II controlled substances.

5. More broadly, Visa requires its U.S. members to periodically examine the Web sites of merchants that they service and requires all Visa merchant Web sites to contain the address of the merchant’s permanent establishment to help consumers determine the identity and assess the nature of an entity with which the consumer seeks to do business over the Internet.

6. Visa also has taken steps to make sure that illegal Internet pharmacies cannot enter its system indirectly.

7. However, Visa has pointed out that in many cases, the only parties that can accurately and effectively determine the legality of transactions, including Internet transactions, are the parties to the transactions themselves.
IV. Internet Child Pornography

A. Background.

1. As the Internet continues to evolve, new concerns have arisen on what can be done to protect children from inappropriate content.

2. Federal legislation has been introduced to protect children from Internet pornography, which includes, among other things, new payment system requirements.

B. Examples of Federal Legislation.

1. On July 27, 2005, Senator Lincoln (D-AR) introduced S. 1507, the “Internet Safety and Child Protection Act of 2005.” Companion legislation (H.R. 3479) was introduced on the same day by Representative Matheson (D-UT).

   a. The legislation would require an operator of a regulated pornographic Web site to verify (using FTC-certified software) that any user attempting to access its site is at least 18 years old.

      (1) Such verification would be required to take place prior to the display of any pornographic material, including free content that may be available prior to the purchase of a subscription or product.

   b. A bank, credit card company, third-party merchant, Internet payment service provider or business that performs financial transactions for a regulated pornographic Web site would only be allowed to process age-verified Internet pornography credit card transactions for sales carried out in accordance with the bill’s requirements.

   c. The FTC would require each regulated pornographic Web site to employ appropriate age-screening software and use it correctly and consistently through such means as conducting periodic tests, which try to access the Web site without appropriate age verifications.

   d. The FTC, in coordination with the Department of Justice, also would maintain a list of regulated pornographic Web sites that are not in compliance.

   e. A violation of the age verification requirements for regulated pornographic Web sites would be treated as an
unfair or deceptive act or practice under the Federal Trade Commission Act.

f. The FTC would be required to issue and enforce regulations for the regulated Internet pornographic Web site age verification requirements.

C. Industry Response to Internet Child Pornography Concerns.

1. Visa has an established program to detect child pornography distributors that accept Visa payment cards.

2. Visa utilizes a third party to sweep the Internet to detect such distributors.

3. Once detected, Visa promptly reports the distributors to law enforcement and cooperates fully in the investigation and prosecution of the persons involved.

* * * * * * *

The foregoing information is provided to attendees of the American Bar Association Section of Business Law program sponsored by the Consumer Financial Services Committee and the Gaming Law Committee for the general information of the attendees only, and does not constitute legal advice.