



PO Box 584
Oakdale, NY 11769
December 6, 2007

Board of Governors of the
Federal Reserve System
20th and C Streets N.W.
Washington, DC 20551

Attention: Jennifer J. Johnson, Esq.
Secretary

Re: Docket No. R-1298
Prohibition on Funding of Unlawful Internet Gambling

Governors:

Radix Consulting Corporation is pleased to comment on the Board's proposed rules to implement applicable provisions of the Unlawful Internet Gambling Enforcement Act of 2006. Radix's purpose for responding to these regulations is based on our factual determination that with regard to Automated Clearing House (ACH) debit transactions and the issuance of demand drafts (unsigned checks that are the paper equivalent of ACH debits) there is a glaring lack of due diligence performed by third-party senders¹ and the originating financial institutions. Inadequate due diligence procedures have created an environment where a number of illegal activities are being funded using the ACH and check collection systems, examples include but are not limited to unlawful Internet gambling, telemarketing schemes, and Internet tobacco sales.

Radix agrees with the Board's comments that it is not practical for the automated clearing house, check collection and wire transfer payments systems operators to block unlawful Internet gambling transactions because of the various characteristics of each of the systems – primarily the lack of information that could identify the transactions as prohibited.

¹ Third party sender is a broad term. This letter defines third party senders as third-party merchant processors and does not include, payroll processors such as ADP, processors that provide financial institution with back-office processing such as FiServ or Fidelity and bill payment third party senders such as CheckFree.

Radix also agrees that certain exemptions should be allowed for participants. However, we do not agree completely with the manner in which the exemptions are envisioned for an originating bank of a credit transfer. In a credit transfer, we agree that if a consumer is initiating a credit transfer through the ACH or wire transfer systems there is no practical way for the originating bank to determine the purpose of the transactions and the exemption should apply. The exemption should not be allowed when the credit transfer is being initiated on behalf of the gaming institution because the originator and the nature of the business of that originator should be known by the originating bank and in the case of a third party sender by the bank and the third party sender. The only logical reason that we can determine for this oversight is that the Act does not cover funding the winners of the gambling activity.

Radix's major concern with the proposed regulations is the lack of specificity with the due diligence procedures especially when third party senders are originating the ACH debit, credit and demand draft transactions. We believe that financial institutions have adequate due diligence procedures for all of their direct customers. Our extensive experience in payment systems and our work with law enforcement agencies investigating Internet tobacco sales has convinced us that the majority of originating financial institutions that are working with third party senders have no idea of the business nature of the transactions that are being submitted by those third party senders. These financial institutions view the third party sender as their customer and not the merchants that are the customers of the third party sender. It gets worse and more complex when there is a nesting of third party senders and the primary third party sender that has the relationship with the originating bank in many cases has no idea of the nature of the transactions being submitted by the nested third party senders. To make matters worse, some financial institutions allow the third party senders to originate transactions directly into the ACH system; the originating financial institution does not even see the transactions and has no idea of what is taking place.

Since the cited payment systems have no ability to stop unlawful debit transactions once they are entered into the system, it is imperative that they be stopped before they are entered into the system or stopped by the receiving institution in the case of transactions that are initiated by consumers. The vast majority of the transactions are initiated using debit transactions, through the ACH and demand drafts through the check collection system. The only way to prevent restricted transactions is to shore up the due diligence procedures. We believe that financial institutions' should know their customers and their customers' customers and propose that more stringent due diligence procedures be employed by third party senders and verified by originating financial institutions before transactions are entered into the payment systems:

Due Diligence Procedures for Primary Third Party Sender

- 1) Before agreeing to provide any services to a merchant, the third party sender shall:

- A. Obtain the merchant's: (i) name (including all known "doing business as" names), (ii) address, (iii) phone number, (iv) type of business or principal business activity, (v) taxpayer ID number, (vi) principals' names, (vii) principals' addresses, (viii) principals' phone numbers, and (ix) principals' taxpayer ID number, and (x) geographic location;
 - B. Conduct a background check of the merchant and its principals by, at a minimum, doing the following: reviewing the merchant's web site, advertising, products, services; cross-checking the merchant's provided information; verifying the information provided by the merchant with external agencies having the ability and expertise to provide such verification (*e.g.*, The Better Business Bureau, Dunn & Bradstreet, etc.); validating the taxpayer ID through income tax filings, incorporation documents, business papers and/or bank account information.
 - C. Review the merchant's sales history for the past three (3) years;
 - D. Use a unique company identifier for the third party sender and include the Merchant Customer's name for each merchant (i.e., no acronyms, abbreviations or telephone numbers) for all transactions submitted for processing
 - E. Outline merchant termination procedures.
- 2) Before agreeing to provide any services to a merchant doing business as a third party service provider, the primary third party sender shall require other third party senders to provide the following information which the primary third party sender shall independently verify:
- A. Identify each of the merchant's customers for whom the primary third party sender would be originating transactions for (i.e. "Merchant Customer");
 - B. Provide primary third party sender with the same information and controls identified in Paragraph 1 above for each Merchant Customer; and
 - C. Use a unique company identifier for each third party service provider and include the Merchant Customer's name for each merchant (i.e., no acronyms, abbreviations or telephone numbers) when processing transactions through the primary third party sender.

Radix believes that the originating financial institution should independently verify the documentation and not rely solely on the third party sender. We agree with the Board's comments that the agreements with all parties should indicate that they will not engage in restricted transactions. As part of their due diligence procedure for dealing with third party senders financial institutions should:

- A. Identify all merchants that the third-party sender will originate transactions for using a set of predetermined information;
- B. Identify any other third party merchant senders or independent sales organizations that may be originating transactions through them; and
- C. Screen all merchant information supplied and perform basic due diligence on the merchant.
- D. Require a unique merchant identifier based on the correct company name in the ACH transactions, no acronyms, abbreviations or telephone numbers;
- E. Identify any other third parties or independent sales organizations doing business through the primary third party sender with unique company identification numbers to provide better tracking;
- F. Request that the third party sender cease origination services for any merchants that violate or do not pass the due diligence procedures of the institution; and
- G. Terminate third party senders who fail to:
 - a. Provide accurate merchant information;
 - b. Notify the bank of new merchants, independent sales organizations or other third party processors;
 - c. Terminate bad originators;
 - d. Switch ACH activity to demand drafts once notified of a problem; or
 - e. Offer demand drafts to avoid ACH return scrutiny.
- H. Agreements with all parties that prohibits restricted or illegal transactions

These procedures may be considered by some financial institutions to be onerous. Financial institutions that understand the risks of accepting transactions without knowing the background of originators have a policy of not doing business with third party senders. Financial institutions that elect to do business with third party senders must implement comprehensive procedures to prevent restricted transactions from entering the payments systems.

In conclusion, Radix supports the implementation and enforcement of the regulations to support the Act. We firmly believe that if financial institutions and third party senders take their due diligence responsibilities seriously then unlawful Internet gambling transactions will cease and other illegal and questionable activity will be eliminated as a by-product of the Act.

Sincerely,



George F. Thomas²

² George F. Thomas has over 26 years of experience working in the financial services industry, primarily with electronic payment systems. He has extensive knowledge of the Automated Clearing House (ACH), the wire transfer systems and check collection systems and recently retired from The Clearing House Payments Company where he was the executive in charge of the Payments Division.

www.radixconsulting.com