

**Testimony of Jon Prideaux
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**Submitted for the Record Concerning
Legislative Hearing on H.R.2046
"Internet Gambling Regulation and Enforcement Act of
2007"**

**Held Before the Financial Services Committee
United States House of Representatives
On Friday, June 8, 2007, at 10:00 a.m.**

1. Introduction

Mr. Chairman and Members of the Financial Services Committee, I am Jon Prideaux. I operate as an independent consultant to the payments industry. I have worked with a range of clients including banks, processors, payment service providers - including SecureTrading Group Ltd who are also testifying at this hearing - and marketing companies. I have not provided any consultancy services to any Internet gambling company and have no plans to do so.

From 1989 to 2006, I worked for Visa in Europe. My responsibilities included the setting of rules globally for the operation of the scheme, as well as being responsible for their enforcement in Europe.

I am grateful for the opportunity to submit written testimony to you concerning my experiences with regulating Internet gambling transactions and ensuring that, to the best extent possible, the freedom of individuals to spend their money as they wish is balanced by concerns to protect the more vulnerable members in society.

2. My Qualifications

For 17 years I was a senior executive at Visa in Europe. I am the immediate past Executive Vice President, Marketing of Visa Europe and member of the Executive Management Committee, responsible to the non-executive Board for the running of the organisation. I led Visa Europe's Internet business as the founder of Virtual Visa, Visa Europe's Internet Division.

I served on Visa's global Product Development Council, which has responsibility for establishing rules and compliance programs for the operation of the Visa system, under delegated authority of the Board. From 1999 to 2006, I was also Chairman of the Visa Europe's Compliance Committee, which had the mission of enforcing the rules and implementing Compliance programs.

I should emphasise that my testimony is in a personal capacity. I am not representing Visa. Nevertheless in my career, I have gathered a great deal of experience about the operation of payment in Internet businesses in general, and Internet gaming businesses in particular. I have also had broad exposure to devising and implementing regulatory structures. I have seen the types of businesses that have generally satisfied customers. I have also seen the types of business models and practices that give rise to customer complaints.

I feel that I am well qualified to provide evidence to the committee about the feasibility of operating Internet gambling in a regulated environment.

3. Gambling and Internet Gambling in the UK and Europe

My evidence will concentrate on the environment for gambling in Europe as a whole and the UK in particular. I shall attempt to answer the question “Can Internet Gambling be Effectively Regulated to Protect Consumers and the Payments System?” It is, Mr. Chairman, my contention that the evidence from Europe shows that it can.

Gambling is a legal, regulated business in the UK and in a number of other European countries. People in the UK wishing to place a bet can go to a race course or dog track and do so directly. They can also go to more than 5,000 licensed betting shops located in the high streets of practically every town in the country. More than 30,000 shops throughout the country sell tickets for the National Lottery. There are also several dozen legal casinos. In addition, Internet gambling is also permitted today and is likely to grow even further following the introduction of the Gambling Act 2005 under which all forms of Internet gambling licenses can be issued.

All these forms of gambling are regulated and taxed by the UK Government. Additionally, the European Court has recently re-affirmed the right of gaming operators to trade freely throughout the European Union.

Gaming operators are some of the largest companies in the country. For example, Ladbrokes, who operate both a physical and an Internet business, have a market capitalization of more than £2.5 billion. William Hill, another large operator, have a market value of more than £2 billion. Both companies are listed on the London Stock Exchange and are members of the FT/SE 250 stock market index. The stocks are widely held and widely traded.

In addition to the largest players there are dozens of other operators, some listed on smaller exchanges such as AIM. These companies specialize in different types of gaming such as sports betting, offering casino games, poker or also operate as betting exchanges.

The total volume wagered is considerable with several billion pounds staked annually.

The UK Government has an explicit strategy to try to make the UK a jurisdiction of choice for Internet gambling companies. In addition there is a strategy to use land-based casinos as a vehicle for regeneration of deprived urban areas.

It would be wrong to say that some of the developments in the UK were completely without controversy, but – essentially – the controversy relates to the location of casinos, rather than to any concerns about the wide availability of gaming opportunities to consumers.

4. Typical Transaction Cycle

Before describing the operation of the regulatory processes, I thought that it might be worthwhile to describe the typical Internet gambling transaction cycle so that the relevant steps can be explained as well as the best places in the cycle for different regulatory processes to be applied.

1. The process starts when a player registers at an Internet site. This is a crucial step. It is the part in the process when the customer must have his identity checked and also when Know Your Customer (KYC) checks are undertaken by the gaming operator. In order to complete registration, the company will often require to see copies of identity documents as well as confirming the customer's identity through the use of various electronic databases and tools. Checks are also applied to ensure that the customer has a good credit rating and does not appear on any blacklist, for example, those designed to prevent Money Laundering or Terrorist Funding. Additionally checks can be undertaken against an industry level blacklist at this stage, for example, to check if the player is on an exclusion list.
2. The next step is for the customer to register a payment device against his account. In order to demonstrate that the customer does in fact have access to the account that he presents for payment, a typical practice is for a micro-credit to be made. The consumer is asked to confirm the exact amount of the micro credit. If he correctly matches the payment, the instrument is registered and can be used to fund the account. All customers who have access to payment instruments from authorized financial institutions must themselves have been through a separate KYC process to obtain it.
3. Once the payment device is registered, the customer can then use it to make a deposit into an account at the Internet gambling site. In Europe, many gambling sites have implemented 3-D Secure. This technology is branded "Verified by Visa" by Visa and "MasterCard SecureCode" by MasterCard. It requires the customer to enter a password in order to complete the transaction.
4. Once deposited into the account, the consumer can use the funds on deposit to place bets or make wagers. The gambling site will require the customer to enter a password each time they sign in to the site, before they can place a bet.

5. Once the bet is placed the result will be known at varying times depending on the game being played: for casino games the result is practically instantaneous while for event betting, the result may not be known for some time. Once the result is known any winnings are credited to the account with only one account permitted per player at a site. The account balance can be used either to make further bets or be withdrawn.

6. The withdrawal of the winnings or any unused deposits will be paid e.g. by cheque or electronically into a bank account (which has been through a registration process as described above) or paid back on to a card – but only in the name of the player. In the case of Visa, following advice and guidance from the UK Police, a system of refunding winnings to the original card account was introduced. This is seen by UK law enforcement as best anti-fraud practice – a fraudster is hardly likely to want to benefit his victim!

It is worth reflecting that at all stages of the process, precisely because the Internet gambling environment takes place in the electronic environment, the degree of control that can be applied far exceeds that which can be applied in the face to face environment where cash is the normal currency. Internet gamblers cannot be anonymous and all the activity that they undertake can be regulated and controlled through a variety of different processes.

5. Multi Layered Regulatory and Control Process

The process of placing a bet ensures that a multi-layered regulatory and control process is brought to bear on the Internet gambling industry.

The player has his identity checked by both the specialist gambling company, under the supervision of the gambling regulatory authorities; further any payment instrument that they might use to fund their gambling has been issued by an authorized financial institution operating under the oversight of the Financial Regulator, finally the payment scheme can also institute various controls to ensure that the payment instrument is used in an appropriate manner.

Together these controls can operate at the time of registration as well as in real time, when funding attempts are made and also at payout.

a) Gambling Regulation

There is an important role for government regulation. It is the responsibility of the government to establish an overall gambling policy and to put in place a licensing regime with appropriate sanctions to ensure that it is upheld. In the UK, licensing and enforcement is the responsibility of the Gambling Commission. Their responsibilities are to ensure that gambling is only operated by fit and proper persons in a fair and open way. Regulation ensures that players get a fair deal and are not cheated. This is considered to be a particular problem in an unregulated market, where disreputable operators – perhaps associated with organized crime - can establish gambling operations.

As well as protecting the vast majority of players who enjoy and can control their gambling, the Gambling Commission is also charged with protecting the vulnerable: they are specifically charged with ensuring that under age and other vulnerable persons are protected from being harmed or exploited, as well as making available assistance to persons who are or who may be affected by problems relating to gambling. The Commission has wide ranging powers to disbar individuals from operating a gaming business as well as to withdraw the license for companies who transgress the rules. Under certain conditions criminal sanctions can also apply.

It is clear that H.R.2046 gives to FinCEN equivalent powers that would enable it to carry out a similar function were the Bill to be passed.

b) Regulation by the Financial Regulator

All Financial Institutions in the UK are under the regulation of the Financial Services Authority (FSA). The FSA has a number of objectives:

- Market confidence
- Public Awareness
- Consumer Protection
- Reduction of Financial Crime

Their controls ensure that persons using bank accounts, credit or debit cards are properly authorized and operate within a regime which seeks to ensure there is an orderly market for the granting of credit, including an awareness of a consumer's ability to pay, is maintained. The FSA has no particular responsibility for gambling, but its generic controls against financial crime and in favor of consumer protection are certainly relevant in the sector.

In the U.S. the Securities and Exchange Commission (SEC) performs a broadly similar role.

c) Regulation by the Payment Scheme

My main experience is with devising and implementing regulations by Visa. The responsibility of the payment scheme is to ensure that laws are respected, that law enforcement requests are facilitated and that the reputation of the scheme is maintained. Notwithstanding the legal position, it is in the interests of the payment scheme to ensure that both buyers and sellers using its products are satisfied that they are being fairly treated and that they have suitable redress in the event of problems.

All Member Banks in the Visa system agree to be bound by its regulations, which provide wide ranging powers to its Board to pass specific regulatory programs and also have generic powers which allow sanctions to be applied for willful breaches of the rules. These sanctions range from fines, through disbarment from certain aspects of the business through to outright expulsion from the system.

The architecture and operation of a payment scheme such as Visa allows considerable scope for intervention at various stages of the payment process.

i. Identification

With respect to Internet gambling, the first priority of Visa was to ensure accurate identification of such transactions. A rule requires all transactions to be accurately flagged with the correct Merchant Category Code (MCC). For Internet Gambling, all transactions are required to be flagged with MCC "7995". The use of this code is defined under the aegis of the International Standard Organization (ISO).

To ensure compliance with the flagging requirement there is a compliance program. Without revealing too many details, it involves a significant sample of test transactions being undertaken at gaming sites and the tracing of those transactions through the system. Where Internet gambling sites are detected not using the 7995 code, the first recourse is to the Acquiring Bank, the bank that has the relationship with the merchant.

When first detected, Acquirers are notified and required to correct the coding error. Subsequently, regular audit transactions are undertaken in order to ensure that the miscoding has been rectified. If not, an escalating schedule of fines is applied.

ii. Authorization

The second prong of the payment scheme regulatory approach is delivered through the authorization process: when the player attempts to load money into his account, a series of checks can be undertaken in order to determine whether to approve or deny the transaction.

The approval can utilize a number of different factors. At Visa, controls were implemented to allow Issuers in particular jurisdictions to deny all Internet gambling transactions should they wish, or be required to by local law. Authorization also can be based on various other controls:

- Velocity controls can deny authorization if too many transactions occur in a defined period of time, offering a mechanism to address compulsive gamblers.
- Value based controls can deny a transaction if the amount spent exceeds the consumer's available credit or funds in their checking account.
- Additionally the location of the merchant is also available to the Issuer, who can update their system to deny transactions from a particular risky country.

These controls can be applied either by individual banks, or alternatively, at a scheme level across all transactions.

iii. Clearing

Approved transactions are cleared through the Visa system: this process allows further checks to be undertaken. Suspicious patterns of transactions can be analyzed for suspected money laundering activities. As and when a suspect transaction is identified, procedures exist for them to be reported to the relevant authorities. Monitoring for suspicious transactions is the responsibility of both the banks involved in the transaction and also the payment scheme itself.

iv. Chargebacks

Once transactions have been cleared through the system, they are posted to the consumer's account. Should he dispute the transaction, he can utilize a process known as "chargeback". A chargeback can be made for specified reasons and sets out a measure of the level of disputes generated by particular merchants.

Visa has defined a program to monitor the level of chargeback occurring and which defines warning levels and penalty levels for merchants generating excessive levels of chargebacks. These programs apply to all merchant types, not only those engaged in Internet gambling.

When the program's penalty thresholds are reached, not only does the Acquiring Bank lose the value of the transaction, but also further penalty fees, on a per-chargeback basis, are applied; the higher the level of dispute, the higher the level of penalty fees. In my experience, merchants with high dispute rates have suffered penalty fees in excess of \$1 million, on a number of occasions. Penalty fees at this level tend to rapidly produce a dramatic improvement in performance.

v. Credit monitoring

Visa also has a program to monitor credits being sent through the system. Checks are undertaken to ensure that payouts relate to bets and that the use of the Original Credit transactions are controlled.

vi. Other Sanctions

In addition to the defined programs defined above, organizations that persistently breach the programs can be subject to specific sanctions. Merchants and their principals have had their acceptance privileges permanently withdrawn. In theory, Member banks can also be expelled from the system, although this power, while threatened, has not had to be exercised.

It should also be noted that individual banks are quite at liberty to have stricter policies, within the global framework defined by the scheme.

6. Outcome

The results of these programs were as follows:

Billions of pounds sterling have been processed annually for many years, with hundreds of thousands of satisfied players.

It is often said that Internet gambling constitutes a high risk sector; I have to say that in my experience, this is not the case. Dispute rates for regulated Internet gambling operators are low, at around 0.10%. This means that, on average, gambling transactions are *less* disputed than average Internet transactions. Internet gambling generates fewer disputes than online music retailing, less than software retailing and around the same level as purchases of airline tickets. The sectors with significantly higher levels of disputes include pornography and ISP subscriptions.

In my experience as the Chairman of Visa Europe's Compliance Committee, I did not receive any complaints relating to problem gambling, or any complaints relating to the cheating of players by Internet gambling sites. During the same period, I had many complaints with respect to other sectors.

It should also be recorded that Visa monitoring did not result in any suspicious transaction reports in regard to money laundering from any Internet gambling site operating in a regulated environment.

7. Conclusion

On the basis of my experience I can unequivocally state that Internet gambling can be regulated, and that abuses can be effectively regulated and controlled.

No one can argue that there will never be any issues with Internet gambling; it is a sad fact that some people, in a free consumer society, overspend and get into debt. Many people spend too much money on drink, on clothes, on shoes and a whole range of other items. Other people can lose money on the stock market, in property deals or through other bad investments. Most people in such a position work through their issues and work hard to repay their losses. Other, more vulnerable, people get to feel that there's no way out for them. Some of them resort to criminal activity or self harm.

The question is not whether the law can prevent gambling from happening. It's perfectly clear that it cannot. The question is whether vulnerable people would be better off if gambling was regulated or whether it was underground.

There is no doubt that in a regulated environment, there are tools to ensure that only fit and proper persons operate the gaming sites. In a regulated environment, controls can be put in place to address problem gambling. In a regulated environment, the taxes raised can be invested in education programs to help people who might have problems. In a regulated environment, blacklists can be established to ensure that players cannot play at any regulated site.

Without regulation, none of these things can be guaranteed.

In a real sense, we owe it to people who have experienced problems with Internet gambling in the past to introduce a regulated environment where the proper protection can be provided to the vulnerable.

8. Closing remarks

I am available to provide further information to the Chairman and other Members of this Committee, as well as to other Members of Congress, regarding my experience with Internet gambling and its control by a payment scheme.

Mr. Chairman, I thank you and the Committee for its time and appreciate the opportunity to submit my remarks for the record.