

Statement of James F. Dowling, President and Managing Director  
Dowling Advisory Group

HR 2266 Reasonable Prudence in Regulation Act  
HR 2267 Internet Gambling Regulation, Consumer Protection, and Enforcement Act

U.S. House of Representatives  
Committee on Financial Services

Thursday December 3, 2009

The Honorable Barney Frank  
Chairman  
Committee on Financial Services

The Honorable Spencer Bachus  
Ranking Minority Member  
Committee on Financial Services

I would like to thank Chairman Frank and Ranking Member Bachus and the Financial Services Committee for the opportunity to testify about this very important legislation. For over 30 years, I have dedicated my professional life to fighting fraud and money laundering. First as a Special Agent with the IRS Criminal Investigation Division where I conducted investigations, acted as an undercover agent in long term investigations and later as the Anti-Money Laundering Advisor with the White House Drug Policy Office where I provided anti-money laundering advice relating to domestic and international money laundering issues. I also had the opportunity to prepare numerous classified and unclassified money laundering threat assessments. Since retiring from government service, I worked in one of the "big four" accounting firms providing anti-money laundering and fraud consulting services to some of the largest financial institutions in the country. I have now started my own firm where I help bank and "non-bank financial institutions" including casinos with anti-money laundering advice. My testimony today is neither as an advocate nor a foe of Internet gaming. Rather, it is to provide this committee with critical information regarding the potential threats from money laundering and terrorism financing relating to Internet gaming. I feel that the current legislation prohibiting Internet gambling-related payments is lacking in regulatory support, and to be successful, the government – probably the Justice Department—needs to provide banks an OFAC-like list of illegal sites that then could be blocked relatively easily. However, legalizing Internet gambling poses significant money laundering and terrorism threats.

The amount of money involved in Internet gambling is difficult to determine accurately. In a GAO report prepared in December of 2002, they estimated that global gaming revenues would be approximately \$5 billion in 2003. Today, some Internet gaming companies state that approximately \$1 billion in revenues are generated from US based Internet gaming alone. Other accounting/consulting firms have estimated the US based

gaming to be over \$57 billion per year with projections that by the year 2011, US gaming revenues will exceed \$79 billion per year. Globally, accounting firms are also estimating annual growth rates of between 1.9% in Europe, the Middle East and Africa to a high of over 15% per year in Asia.

Because this is such a “high stakes” issue, published reports reflect that The Poker Players Alliance has spent over \$400,000 on lobbying efforts in a three month period alone to push for the legalization of online poker. Internet gambling is a high dollar volume business in a borderless multinational structure which creates a good environment for significant money laundering and terrorism financing. The controversy surrounding Internet gaming is not a new one. The Financial Action Task Force (FATF) has issued three different advisories regarding money laundering from both Internet and land-based casinos. FATF is an independent inter-governmental body that develops and promotes policies to protect the global financial system against money laundering and terrorist financing. Recommendations issued by the FATF define criminal justice and regulatory measures that should be implemented to counter this problem. These recommendations also include international cooperation and preventive measures to be taken by financial institutions and others such as casinos, real estate dealers, lawyers and accountants. The FATF recommendations are recognized as the global anti-money laundering and counter-terrorist financing standard.

In FATF's 2009 report on Money Laundering issues in casinos, they made key findings and observations about threats from a global perspective regarding Internet gambling. Some of those findings are:

- “A number of jurisdictions clearly lack awareness of money laundering and terrorist financing risks in the casino and gaming sectors.
- A significant number of jurisdictions have limited regulatory controls, including “fit and proper” tests for casino owners, managers and staff, internal controls, etc. A greater number of casino sectors are not yet subject to any AML/CFT controls, in particular in developing countries. Very few jurisdictions regulate junket operators.
- Vetting, licensing and training relevant employees – jurisdictions raised the need to ensure that staff with a potential to impact on the integrity of the casino operation should be vetted and appropriately trained in AML/CFT. There are significant gaps in coverage of staff in some gaming jurisdictions.
- Internal controls – Most jurisdictions require casinos to have a documented set of internal controls over almost all aspects of casino operations. Some require the regulator to approve these whilst others require the documented controls to meet a set of specified standards
- Law enforcement agencies and regulators report the need for and implementation of suitable tools that carry effective, proportionate and dissuasive sanctions to use in the regulation of casinos, which are willfully negligent in AML. Results of Mutual Evaluations indicate a lack of effective regulatory tools for casinos across members of the FAT.”

US regulatory agencies face significant challenges in regulating land-based casinos and enforcing these laws and regulations. The additional challenges of attempting to regulate “virtual” casinos or gaming companies would put additional burdens on already over taxed resources as identified in the FATF report.

In addition to the FATF advisories, the Government Accounting Office (GAO) prepared a report for Congress and specifically for this very committee entitled "Internet Gambling, An Overview of the Issues, December 2002" which discussed the potential perils of Internet gaming relating to money laundering and terrorism financing. In that report, the GAO states: "...global revenues from Internet gaming in 2003 are projected to be \$5.0 billion dollars. In 1996, Congress created the National Gambling Impact Study Commission to examine the social and economic impacts of gambling, including Internet gambling, by conducting a comprehensive legal and factual study. In its 1999 report, the commission recommended (1) that the federal government prohibit any Internet gambling not already authorized and encourage foreign governments not to harbor Internet gambling organizations, and (2) that Congress pass legislation prohibiting the collection of credit card debt for Internet gambling.<sup>2</sup> The social and economic concerns about Internet gambling raised in the report included underage gambling, pathological gambling, lack of consumer protections, and criminal abuse. In response to these concerns, numerous bills were introduced in Congress to prohibit Internet gambling."

Because Internet gambling is essentially borderless activity, from a money laundering and terrorism financing perspective, it creates a regulatory and enforcement quagmire. To understand these difficulties we must look at the money laundering methodology. Money laundering occurs at three different stages—placement, layering, and integration. In the placement stage, funds from illicit activity are converted to monetary instruments or deposited into bank and “non-bank financial institutions”. In the layering stage, the funds are moved to other institutions and accounts through various activities to obscure their origins. Finally, in the integration stage, the funds are used to acquire legitimate assets or fund further activities. Money-laundering through online gaming normally takes place at the layering stage of the money laundering model whereas in land-based casinos the money laundering normally takes place at the placement stage. Law enforcement and regulators have the most success identifying and stopping money laundering at the early stages of the process which is the placement stage. The chances of law enforcement or regulators identifying money launderers at the layering stages are greatly diminished and near impossible at the integration stage. Now because of advances in technology in the financial systems, things such as "e-currency", “e-wallets” stored value cards, prepaid cards and “mobile technology transfers”, the layering stage of money laundering is faster and more anonymous. With the globalization of our financial systems, the transfer of funds across national and international boundaries is not only easy; it has become a common day occurrence.

In the United States under Title 31, casinos are considered "financial institutions" and as such are subject to anti-money laundering requirements. The work I have done in casinos has given me the opportunity to observe the systems and processes that they

go through in order to properly identify the customers coming into the casino. The casinos have extremely sophisticated electronic surveillance systems that allow them to observe and identify customers that come into the casino and preserve videotape of their activity should that activity be deemed suspicious. Integrated with the electronic surveillance systems that casinos operate, they also employ physical surveillance of the casino floor to observe patrons and to identify fraud and money laundering incidents. In addition to the physical electronic surveillance, the compliance department for land-based casinos integrates the technology to help them in identifying suspicious activity relating to money-laundering and terrorism financing along with fraud. In addition to the aforementioned measures, land based casinos (including Indian Casinos) have state or tribal regulators on site 24/7 walking the floors of casinos to ensure compliance with gaming laws and regulations and assisting in identifying fraud and money laundering. Internet gaming companies would not have that capability.

Land-based casinos also have the ability to physically verify the identity of the person conducting the gaming and then physically verify their identification to ensure it matches that person. In all land-based casinos, if a person fails to provide the casino with reliable identification upon reaching certain gaming limits, then the casino will bar them from any further gaming activity and place them on a blocked customer list. Until the customer provides proper identification to the casino, they will not be allowed to gamble at that casino. Internet gaming on the other hand has no way to effectively and accurately verify the person who is actually gambling. Without these key ingredients, it is impossible to create a Customer Identification Program (CIP) for an online gaming company which is required under 31 CFR 103.64.

If an online gaming company cannot accurately identify the person who is actually conducting the gaming (financial transaction) then it is impossible for these companies to comply with provisions of the Office of Foreign Asset Control (OFAC) and other sanctions programs. The obvious gaps here would easily allow for not only money laundering but also terrorism financing to take place without detection. We have seen the results when financial institutions fail to comply or willfully circumvent provisions of the OFAC provisions in such institutions as Lloyds Bank and other international institutions. The failure to comply or intentionally circumvent our sanction regulations could have devastating results.

In addition to the FATF and GAO reports, the current National Money Laundering Threat Assessment and FinCEN have identified money laundering issues in casinos. In a FinCEN Advisory issued on July 1, 2009, FinCEN stated "The Financial Crimes Enforcement Network ("FinCEN") recently received information from law enforcement and regulatory authorities that certain casino personnel may have complied with requests from patrons to evade, or provided instructions to patrons on how to evade, reporting and recordkeeping requirements under the Bank Secrecy Act."

Until the true identity of the person actually conducting the Internet gambling can be determined, then the potential risks for money laundering and terrorism financing would negate any business opportunity.

Thank you for the opportunity to provide these comments and I would be happy to answer any questions or provide any additional testimony or information on money laundering and terrorism financing with respect to land-based or Internet casinos.