

**BUYER BEWARE: THE DANGER OF PURCHASING
PHARMACEUTICALS OVER THE INTERNET**

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**Before the
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE**

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Good morning, Chairman Coleman, Senator Levin, and Members of the Subcommittee. My name is Joshua Peirez, and I am Senior Vice President and Assistant General Counsel at MasterCard International Incorporated in Purchase, New York. It is my pleasure to appear before you today to discuss the important issue of the sale of pharmaceuticals over the Internet.

MasterCard deplores the use of its system for any illegal purposes, including for the illegal purchase of pharmaceuticals. MasterCard has recently taken a number of steps to help prevent Internet pharmacies from accepting MasterCard cards for illegal pharmaceutical sales. MasterCard takes its obligations very seriously and is committed to doing its part to address this important issue. These steps, which are discussed in greater detail below, include: (i) working with our customer financial institutions to shut off more than 370 web sites from accepting MasterCard-branded payment cards in connection with the illegal sale of pharmaceuticals over the Internet; (ii) publishing a bulletin to all of our customer financial institutions worldwide reminding them of their obligations to ensure that the MasterCard system is not used for illegal pharmaceutical sales or other illegal transactions; (iii) exploring new ways to protect the MasterCard system against use for illegal activities; and (iv) working with the Drug Enforcement Administration ("DEA") and the Food and Drug Administration ("FDA") in a collaborative fashion. The efforts we have taken to date represent important steps in demonstrating MasterCard's commitment to play an appropriate role in addressing this issue. It is my belief that MasterCard could do more with the proper tools that can be provided legislatively.

An example of such a tool is included in S. 2493 introduced by Senator Judd Gregg (R-NH), the Safe IMPORT Act. The legislation clearly delineates those Internet pharmacies permitted to sell prescription drugs over the Internet from those that are not. Such an approach will be helpful to MasterCard in keeping prohibited transactions and entities out of our system. The Safe IMPORT Act also includes provisions intended to statutorily impose obligations on MasterCard and other financial institutions to stop payments related to illegal Internet pharmacy sales. As discussed below, we urge that changes be made to the legislation to ensure that the desired objectives can be implemented most effectively. It is MasterCard's view that the current

language of the bill could create operational difficulties and may actually diminish MasterCard's ability to meet the broader objectives intended by many policymakers. I discuss these and other issues in greater detail below.

Background

MasterCard is a global organization comprised of more than 23,000 financial institutions that are licensed to use the MasterCard service marks in connection with a variety of payments systems. It is important to note that MasterCard itself does not issue payment cards nor does it contract with merchants to accept those cards. Instead, those functions are performed by our customer financial institutions. The financial institutions that issue payment cards bearing the MasterCard brands are referred to as "Card Issuers." The financial institutions that enter into contracts with merchants, including Internet pharmacies, to accept MasterCard-branded cards are referred to as "Acquirers." MasterCard provides the networks through which the customer financial institutions interact to complete payment transactions and sets the rules regarding those interactions.

A core fundamental rule of our system is that each customer financial institution must conduct its MasterCard programs and activities in accordance with all applicable laws. This includes, for example, ensuring that any transaction a customer submits into the MasterCard system pertains to only legal activity. MasterCard also has a series of rules that require Acquirers to ensure that the merchants they contract with to accept MasterCard-branded cards are legitimate and engage in solely legal activities. These rules mandate, among other things, that Acquirers perform due diligence on a merchant before authorizing the merchant to accept MasterCard cards and that Acquirers monitor merchants for compliance with the rules. Customer financial institutions that fail to comply with the rules may be required to absorb the cost of any illegal transactions, and may be assessed fines, suspended or terminated, in MasterCard's sole discretion. MasterCard also works extensively with law enforcement officials to address situations where the legality of activities related to MasterCard payment card transactions is in question. For example, in the U.S., MasterCard works with a variety of federal and state law enforcement agencies on these issues generally, including state Attorneys General, the DEA, the FDA, the U.S. Secret Service, the Federal Bureau of Investigation, and other branches of the Department of Justice. A major objective of these efforts is to ensure that MasterCard provides appropriate support to law enforcement in their efforts to address illegal activity. We are sensitive to the fact that our efforts to enforce the MasterCard rules have the potential to hinder ongoing law enforcement investigations and the like. For example, when a merchant is shut off from accepting MasterCard-branded cards because the merchant violated our rules, law enforcement's ability to gather evidence through our system can be impeded and shutting off a merchant might be a tip-off to that merchant of an ongoing investigation.

Efforts to Address Illegal Pharmaceutical Sales

MasterCard first became involved in efforts to address the important issue of illegal pharmaceutical sales over the Internet after an inquiry from the House Energy and Commerce Committee on December 9, 2003. Less than a week later, on December 15, 2003, we met with majority staff of the House Energy and Commerce Committee who explained the efforts that were underway in Congress to find solutions to this issue, including solutions that may involve

payments systems. Shortly thereafter, we met with staff of this Subcommittee to discuss how MasterCard handles these issues, and what role MasterCard could play in the future. That meeting with your staff, Mr. Chairman, was particularly helpful in highlighting the magnitude of the problem and in clarifying some of the legal issues surrounding the Internet sale of pharmaceuticals, particularly the issues as they relate to controlled substances. We also met with staff of the DEA and FDA to exchange information and to explore ways in which MasterCard could be helpful to them in their efforts against illicit Internet pharmacies. Prior to this series of meetings, MasterCard did not have sufficient knowledge of the legal issues involved in the Internet pharmacy debate to take action.

Based on the information we received during these meetings, MasterCard embarked on a three-pronged proactive approach to address this issue. First, MasterCard established a working relationship with appropriate officials at the DEA and FDA. As a result, we have had a number of meetings and conversations to identify ways in which MasterCard could be helpful to the agencies in connection with their enforcement efforts, and we successfully established lines of communication that remain open in order to exchange information and do our part to assist in apprehending those violating the law. We have also provided information to the DEA on several occasions to help it with ongoing investigations.

Second, we sent a bulletin entitled "MasterCard Rules Prohibit MasterCard Transactions for Illegal Activities" to all of our customer financial institutions worldwide. (See Attachment 1). This bulletin reminded our customer financial institutions of their obligation to ensure that the MasterCard system is not used for illegal activity. The bulletin specifically highlighted Internet pharmacy transactions as involving a heightened risk of potential illegal activity. The bulletin also reminded customer financial institutions of their obligation to perform due diligence of merchants, including Internet pharmacies, before allowing them to accept MasterCard cards, to properly identify MasterCard transactions that are submitted into the system, and to ensure that merchants accepting the MasterCard cards comply with applicable law. The bulletin went on to note that if there was a lack of clarity regarding the legality of particular transactions, the customer financial institution should not submit those transactions.

Third, MasterCard directed its merchant security team to search the Internet for Internet pharmacies that purport to accept MasterCard-branded cards for illegal sales of controlled substances. These initial efforts identified approximately 400 web sites that appeared to be engaged in the illegal sale of pharmaceuticals—both controlled substances and other prescription drugs. For each of these sites, MasterCard attempted to identify the Acquirer that contracted with the Internet pharmacy to accept MasterCard-branded cards. In some cases, we could readily identify the Acquirer through "dummy" transactions. However, because MasterCard and its employees are prohibited by law from knowingly making illegal buys, MasterCard security personnel could not legally complete any transactions, making it difficult to identify the Acquirer in some circumstances. MasterCard then directed each of the identified Acquirers to stop immediately the Internet pharmacy from accepting MasterCard cards as payment for the illegal sale of pharmaceuticals. MasterCard also directed the Acquirer to respond in writing either to confirm that it had stopped the merchant's acceptance of MasterCard-branded cards or to confirm that the merchant was not engaged in illegal activities and to provide all documentation regarding the steps the Acquirer had taken to confirm the legality of those activities. We also reminded the Acquirer that any failure to comply with MasterCard's instructions might subject

the Acquirer to fines, penalties, suspension, or termination by MasterCard. We are pleased to report that, to date, these efforts have been largely successful in shutting off the acceptance of MasterCard cards at more than 370 web sites. We note, however, that we have seen already some web sites that have been terminated through one Acquirer popping up elsewhere in our system. Unfortunately, this reflects one of the limitations of private enforcement efforts by industry. Although we can be successful in shutting off web sites engaged in illegal activity, we do not have the ability to uproot the bad actors the way state and federal law enforcement could. As a result, our security personnel sometimes feel that the problem resembles a game of "whack-a-mole," where they successfully terminate a merchant in one spot only to have it pop up in another spot.

MasterCard also is working on identifying ways in which we can strengthen our existing protections against the introduction of illegal transactions into our system. In particular, we are developing a plan to use one or more third-party firms to audit Acquirers for certain merchant categories to ensure that they are complying with their due diligence and other obligations to screen merchants before authorizing them to accept our cards. Under this plan, we would likely retain auditing firms to prepare audit reports for MasterCard regarding their findings. Those reports would then be used to work with Acquirers on any areas that need improvement and to help lay the groundwork for any disciplinary action that may be necessary. The feasibility of such a program is under review at this time.

Although MasterCard has had success to date in addressing this situation, the task has been made more difficult by a lack of clarity on what sales of prescription drugs by Internet pharmacies are actually illegal. In this regard, it appears that there are unlikely scenarios that the sale could be legal if it met a variety of standards, which generally can only be confirmed through actually completing a purchase from the web site which, as mentioned above, MasterCard cannot legally do at this time. It is our understanding from staff of the DEA and FDA that these standards are almost never achieved, and therefore that the activity is virtually never legal. However, the lack of a clear prohibition has made it more difficult to educate our Acquirers about the illegality of the sale of pharmaceuticals over the Internet to U.S. cardholders.

Legislation

MasterCard agrees that federal legislation on the issue of Internet sales of pharmaceuticals could be helpful in a number of areas. The Safe IMPORT Act, for example, contains provisions that would reduce the confusion regarding a number of legal issues surrounding the sale of pharmaceuticals via the Internet. In particular, pharmacies would need to be licensed to sell pharmaceuticals using the Internet, and a list of such licensees would be made public. Such a list could be helpful to MasterCard and its customers in having a clear understanding of whether particular pharmacy merchants are engaged in legal activities. And this knowledge will be useful in preventing illegal transactions from flowing through our system.

We also note that other provisions of the Safe IMPORT Act would statutorily impose obligations on MasterCard and other financial institutions to stop transactions involving the unlawful sale of pharmaceuticals over the Internet. As noted above, MasterCard is fully committed to doing its part to address this important issue. If Congress decides that it is necessary to impose statutory obligations on payments systems, MasterCard is prepared to

comply. MasterCard requests, however, that any such statutory obligations be carefully crafted to ensure that MasterCard can be an effective participant in the fight against the illegal sale of pharmaceuticals over the Internet. Accordingly, we have a number of suggested changes to the legislation that we believe would be necessary to ensure that MasterCard can play an appropriate and effective role. For example, with respect to MasterCard and other similar payments systems, we believe the bill should impose obligations on the systems themselves rather than on the financial institutions that participate in those systems. The bill currently would impose obligations on financial institution participants in the U.S., most of whom will have little if any direct control over the Internet pharmacies Congress seeks to address. For example, in the MasterCard system, the financial institutions that would be most affected by the bill would be card issuers that issue payment cards to consumers here in the U.S. but have no relationship with, or ability to control, Internet pharmacies that are signed up by Acquirers. To address this issue, MasterCard would suggest that the obligations be imposed on MasterCard itself, and MasterCard can adopt policies and procedures to prohibit Acquirers from permitting unlicensed Internet pharmacies from submitting restricted transactions into the MasterCard system.

We also urge that the Safe IMPORT Act be modified in other respects. Currently, the bill directs that certain federal agencies adopt rules to effectuate "coding and blocking" of restricted transactions. In other words, Acquirers would be required to "code" Internet pharmaceutical sales in a certain manner, and Card Issuers in the U.S. would be required to "block" the authorization of transactions having that code. The focus on coding and blocking in S. 2493 would inadvertently undermine efforts to achieve the broader goal of permitting some Internet pharmacy sales while prohibiting others. Our system is not designed in a way that would enable us to distinguish one type of Internet pharmacy sale from another. This is because the electronic message layouts used by our system do not enable coding to make distinctions at those levels in the two seconds or so in which the message is transmitted back and forth through our system. Instead, any sale made by a pharmacy, whether for an illegal sale of prescription drugs, a legal sale of prescription drugs, or the sale of household items, could be coded as a "pharmacy" transaction. If the sale is made via the Internet, a separate code is used to indicate that fact. If the coding and blocking approach included in the bill were implemented in our system, system participants would have little choice but to over-comply and block all transactions involving both the pharmacy code and the Internet code. This would mean that transactions would be blocked regardless of whether the Internet pharmacy involved was licensed and regardless of whether a pharmaceutical was sold. To avoid this result, MasterCard suggests that the legislation be modified to provide more flexibility to allow payments systems to choose the best method available to them to prevent restricted transactions. As indicated earlier, for the MasterCard system, we would likely use an approach aimed at the front end of the system, by working with our Acquirers to stop the restricted transactions from unlicensed pharmacies from being introduced into our system in the first place.

The Safe IMPORT Act also includes a helpful provision that would provide a safe harbor for stopping "restricted transactions" from successfully flowing through the payments systems. This is an important provision because efforts by the payments systems to stop transactions that may be legal in other countries create the potential for liability and litigation. We are concerned, however, that the current safe harbor is not broad enough. For example, it is unavoidable that MasterCard and others seeking to implement procedures to stop restricted transactions will inadvertently prevent some transactions that are permissible. Indeed, there is no perfect system

for distinguishing restricted from unrestricted transactions, and it may be prudent to err on the side of over-compliance with the statutory obligations rather than run the risk of a statutory violation.

We also believe that it is important to ensure that MasterCard and other payments systems are appropriately empowered to police their own rules. As discussed above, one of the current limitations in this area that has come to our attention as a result of our ongoing efforts to stop illegal transactions is that MasterCard itself cannot actually complete an Internet prescription drug purchase to confirm that the Internet pharmacy is engaged in illegal activity. We have been informed by DEA officials that making such a transaction would cause MasterCard to violate the law. To address this issue, we urge that any legislation imposing obligations on payments systems enable those payments systems to legally engage in transactions with licensed and unlicensed pharmacies as part of their efforts to ensure compliance with payments system rules.

Finally, we urge that any legislation requiring payments systems to stop illegal Internet pharmacy transactions include provisions establishing that legislation as the uniform national standard for Internet prescription sales. It would not be appropriate to require MasterCard and others to adopt dozens of different systems to prevent certain Internet pharmaceutical transactions to comply with a variety of state laws. Given the way our system operates, we would be forced to use only the highest standard, as we cannot distinguish based on what state a cardholder resides in. Indeed, such a patchwork approach would detract from dedicating resources to a proven approach embodied in federal law.

Chairman Coleman and Senator Levin, thank you again for the opportunity to discuss these important issues with you today. MasterCard intends to do its part to prevent the illegal sale of pharmaceuticals over the Internet, and we look forward to continuing our work with each of you. It has also been our pleasure to work with Subcommittee staff and the DEA, FDA, and others, and we look forward to continuing these efforts. I would be glad to answer any questions you may have.

MasterCard Rules Prohibit MasterCard Transactions for Illegal Activities

Joshua Peirez, Senior Vice President and Assistant General Counsel, Legal Department

Suggested routing: Compliance Contact, Legal Contact, Principal Contact, Risk Management Contact

Summary: This bulletin reminds members of the MasterCard Standards prohibiting the use of MasterCard systems for any illegal activities and the importance of adhering to the Standards.

Action Indicator: **M** Mandate

Effective Date: Immediately

This bulletin reminds members of the MasterCard Standards prohibiting the use of MasterCard systems for any illegal activities and the importance of adhering to the Standards.

Background

Strict adherence to the Standards has become increasingly important as the use of the Internet and e-commerce has grown and created new means by which people may attempt to use MasterCard® payment cards as a payment mechanism for activities that may not be legal in all jurisdiction(s).

Transactions that present heightened risks of potentially illegal activity include Internet payment for transactions involving gambling, pornography, and prescription medications.

Member obligations

Members should adhere to the following obligations to ensure compliance with MasterCard Standards.

Due diligence

Under MasterCard Standards, members must conduct due diligence on those merchants they elect to acquire from before permitting those merchants to accept MasterCard payment cards. This due diligence minimally must include ensuring that each such merchant is engaged in a bona fide business and not engaged in illegal activity.

If there is reasonable doubt with respect to the legality of the merchant's activities in any jurisdictions in which it intends to provide goods or services, the acquirer should not permit the merchant to accept MasterCard payment cards and must not acquire transactions from the merchant until the legality of the merchant's activities can be confirmed.

In addition, the acquirer periodically should check the merchant's Web site and business activities after conducting the initial due diligence screening to confirm that the merchant continues to sell the goods or services for which they entered into a contractual relationship with the acquirer, and is not engaging in illegal activity or activity that is contrary to MasterCard Standards.

Properly identified transactions

Another obligation incumbent on acquiring members is to ensure that transactions are properly identified within the MasterCard system. For example, an authorization request involving Internet gambling transactions must contain the proper codes indicating that the transaction is a gaming transaction and is being conducted by the cardholder via the Internet. For more information about coding, please refer to *Global Security Bulletin* No. 10, 17 October 2000.

Comply with all applicable laws

MasterCard Standards require all members to comply with all applicable laws and not to engage in illegal behavior, or in behavior that would cause MasterCard to violate any laws. Refer to Rule 3.1 in the *Bylaws and Rules* manual, which states: "Each member must conduct its programs and other activities that utilize or otherwise involve any of the [MasterCard] Marks in compliance with the Standards and with all applicable laws and requirements imposed by government or regulatory authority."

Also, MasterCard Standards obligate acquirers to ensure that merchants comply with the Standards as well. Refer to Rule 9.1.3 in the *Bylaws and Rules* manual, which states: "[Acquiring] member is responsible for ensuring that each of its merchants complies with the Standards."

MasterCard is working with law enforcement

MasterCard is working with law enforcement officials to address situations where the legality of activities related to payment card transactions is in question. For example, in the United States, MasterCard is working with a variety of federal and state law enforcement agencies on these issues, including:

- State attorneys general
- Drug Enforcement Administration

- Food and Drug Administration
- U.S. Secret Service
- Department of Justice
- Federal Bureau of Investigation

MasterCard also requires its members to act in such a way as to not cause MasterCard to violate any law applicable to MasterCard. Members that fail to comply may be required to absorb the cost of any illegal transactions, and may be assessed, suspended, or terminated at the sole discretion of MasterCard.

For more information

If you have any questions about the issues discussed above, or if you have any other concerns, please contact the following individuals in the Law Department:

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To report an illegal transaction processed by your bank's merchants, contact the appropriate law enforcement agency and one of the following:

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