

WHITE PAPER: CLOSING CREDIT CARD CONTRIBUTION LOOPHOLES

Take Back Our Republic believes strongly in the important role of contributions from individuals in providing funding to political campaigns. Increasing the role of individual citizens in the American political system lies at the heart of our mission, whether they choose to exercise their political rights through financial contributions, active involvement in political campaigns, or other types of advocacy for the candidates and causes they support.

However, increasing the role of contributions from individuals in the system, many of which will be small contributions, also means that regulation of campaign finance must take special care to guard against abuses of that system, in particular as these affect low-dollar contributions from individuals. Specifically, the system of regulation must ensure, to the greatest degree possible, that *only* Americans contribute to campaigns for Federal and State office. A loophole in the current system of campaign finance regulation as it affects credit card contributions, particularly those made online, may make it easier for non-citizens to contribute to campaigns. In this White Paper, we discuss the issue and offer several suggestions for reform. We begin with a short discussion of credit card regulation, designed to assist in understanding how the current loophole could exist.

REGULATION OF CREDIT CARDS

As with other types of financial services, the regulation of credit cards is complex and is effectively spread across several agencies of the Federal Government, with responsibility depending on the nature of the issue concerned.¹

For instance, the Consumer Financial Protection Bureau (CFPB) administers a number of the requirements under the CARD Act.² It also now administers Regulation E³ governing electronic fund transfers under the provisions of the Electronic Fund Transfer Act⁴ as well as Regulation Z,⁵ implementing provisions of the Truth in Lending Act and other statutes relating to consumer credit. The Federal Deposit Insurance Commission issues regulations governing member banks that issue credit cards.

¹ This memo is limited to discussion of the use of credit cards for contributions to political campaigns. Similar, perhaps even more challenging, issues also exist with respect to the use of debit cards and prepaid cards.

² Credit Card Accountability Responsibility and Disclosure Act of 2009, 123 Stat. 1734 et seq. (2009). See also <http://www.consumerfinance.gov/credit-cards/credit-card-act/feb2011-factsheet/> for further information about CARD Act provisions.

³ 12 CFR 205; <http://www.federalreserve.gov/bankinfo/reg/cecg.htm>

⁴ 15 U.S.C. 1693 et seq.

⁵ 12 CFR 226, 1026; <http://www.federalreserve.gov/bankinfo/reg/zcg.htm>; <http://www.consumerfinance.gov/eregulations/1026-1/2015-01321#1026-1-a>. Earlier versions of Regulations E and Z were promulgated by the Board of Governors of the Federal Reserve System.

But for this discussion perhaps the most important type of regulation of credit cards is *self-regulation*. The two national credit card associations (Visa and MasterCard), along with others, have developed protocols designed to ensure, to the highest degree possible, the safety and security of credit cards. This makes sense. Banks that issue the cards have a strong incentive to protect against fraud, and consumers have come to rely on these protections in their use of credit cards.

The two most important self-regulatory initiatives for purposes of this discussion are the CVV (Card Verification Value) or CSC (Card Security Code) and AVS (Address Verification System) systems.

The CVV system is familiar to every American using a credit card. Many, if not most, merchants conducting online or telephone transactions involving a credit card will ask for the three- or four-digit security code on the back of the credit card. Most basically, this provides an additional measure of security: unless that number has itself been compromised, it is designed to ensure that obtaining a cardholder's name and card number through fraud will not be enough to permit charges against that card.

There are actually a variety of CVV or card security codes, depending on the issuer of the card (for instance, Visa, MasterCard, or American Express) and the type of code. The most important type of code for contributions to political campaigns is the CVV2 code (the three- or four-digit number). For transactions in which the card is presented to a merchant (which for these purposes includes a political campaign accepting credit card donations), the embedded information in the magnetic stripe on the card provides a means of verification. For transactions in which the card is not presented – including transactions made online – the CVV2 number provides the means of verification. As a further security measure, the merchant does *not* store the CVV2 number, thus reducing the risk of fraud or compromise of the number.⁶

The AVS is exactly what its name implies: a system by which merchants may verify the address of a cardholder before completing a transaction, particularly an online transaction.⁷ The AVS system is especially important for political campaigns, as an AVS check revealing that a cardholder has a foreign address (or is using a card issued by a

⁶ Some merchants keep cardholder information on file; others do not. We take no position on this issue: whether a merchant (including a campaign) chooses to store the basic information such as name, address, and card number depends on a variety of factors, including the types of transactions routinely conducted, the merchant's confidence of the level of security its systems provide, and how often cardholders make repeated transactions. For instance, a campaign that offers campaign-related merchandise such as buttons for sale may choose to retain cardholder information on that portion of its site (or to delegate the processing of these transactions to a third party), but that same campaign may not choose to keep cardholder information regarding direct contributions on its site (other than as necessary for reporting purposes).

⁷ This article gives a useful summary of AVS codes for the different card associations:

https://en.wikipedia.org/wiki/Address_Verification_System. See also <http://virtualtrak.blogspot.com/2007/03/address-verification-system-avs.html>

foreign bank) should prompt additional verification measures to ensure that the person attempting to contribute to the campaign is legally required to do so.

The AVS is a critical component of systems designed to prevent online card fraud. It helps merchants avoid “chargebacks” (liability for fraudulent transactions) by ensuring that the person presenting the card has given the correct address while making an online credit card transaction. Merchants in these situations may also have to pay a fine to the credit card association under whose auspices the transaction was attempted; this alone should provide a clear incentive for campaigns, many of which are managed on a tight budget, to use the AVS system.

THE CREDIT CARD LOOPHOLE

It is against Federal law for campaigns [[knowingly]] to solicit or accept contributions from foreign sources. Federal law likewise requires that contributions over \$200 be reported publicly; records of contributions between \$50 and \$200 must be kept by the campaign and produced if audited, while contributions under \$50 need not be recorded.

During the 2008 and 2012 elections, allegations were made that a large number of campaigns for Federal office, including at least one Presidential campaign and over 200 Congressional campaigns, were not using anti-fraud protections such as the CVV code. As the Washington *Post* reported in 2008,

Sen. Barack Obama’s presidential campaign is allowing donors to use largely untraceable prepaid credit cards that could potentially be used to evade limits on how much an individual is legally allowed to give or to mask a contributor’s identity, campaign officials confirmed.

Faced with a huge influx of donations over the Internet, the campaign has also chosen not to use basic security measures to prevent potentially illegal or anonymous contributions from flowing into its accounts, aides acknowledged. Instead, the campaign is scrutinizing its books for improper donations after the money has been deposited. * * * [the campaign stated that] “the campaign does a rigorous comprehensive analysis of online contributions on the back end of the transaction to determine whether a contribution is legitimate.”⁸

The article also highlighted the case of a woman who allegedly gave over \$174,000 to the Obama campaign (at a time when the legal limit was \$2300); in fact, she had given nothing. Her name had been compromised, perhaps (if not likely) through the use of

⁸ Matthew Mosk, “Obama Accepting Untraceable Donations,” *Washington Post*, Oct. 29, 2008, available at <http://www.washingtonpost.com/wp-dyn/content/article/2008/10/28/AR2008102803413.html?sid=ST2008102803431>.

credit cards, even though her credit card was not actually billed for the supposed contributions.⁹

The Obama campaign was correct that back-end review was (and remains) fully compliant with all FEC regulations. We are convinced, however, that this “credit card loophole” makes it too easy for foreigners potentially to contribute to Federal election campaigns – particularly when the fix, using anti-fraud provisions, is so easy.

Nor have these problems been limited to one campaign and certainly not to one party. According to a 2012 report from the non-partisan Government Accountability Institute,¹⁰ in that cycle fully 47.3 percent of House and Senate members who maintained an online donation page “[did] not require” the CVV code “for Internet contributions.”¹¹ (While the report did not consider the websites of challengers to incumbents in that cycle, one may presume that the problem exists to some degree with challengers’ websites as well.) GAI was not able to verify similar statistics regarding use of AVS systems.

Further, the report suggests that avoiding use of anti-fraud systems also potentially opens the door to “robo-donations” – recurring small contributions designed to evade reporting requirements,

One curious aspect of all this is that not using the CVV system involves paying a higher fee to the bank processing the online transactions. Presumably campaigns would want to limit regulatory and compliance fees to the minimum necessary to maximize funds available for campaign activities such as advertising, get-out-the-vote activities, and other efforts. So it would make sense for campaigns themselves to want to use these anti-fraud protections, not only to reduce costs during an actual campaign but to reduce the possibility of audits and corrective action taken after the fact – not to mention the fact that candidates for Federal office should want to comply with laws governing campaign finance, in particular ensuring that only Americans participate in the process.

IDEAS FOR REFORM: LEGISLATIVE AND OTHER OPTIONS

There are a variety of possible approaches to close the loophole; this list is not meant to be exhaustive but merely to provide a starting point for discussion.

Congress directs the FEC to close the loophole

Perhaps the simplest legislative fix would be for Congress to instruct the FEC to issue regulations to fix the problem. As these regulations could be subject to notice and

⁹ Biskup, who had scores of Obama contributions attributed to her, said in an interview that she never donated to the candidate. "That's an error," she said. Moreover, she added, her credit card was never billed for the donations, meaning someone appropriated her name and made the contributions with another card. *Id.*

¹⁰ Available at <http://campaignfundingrisks.com/full-report/>

¹¹ *Id.*

comment rulemaking,¹² it could take some time for the regulations to come into effect. And if the provisions of these regulations were to become the subject of partisan disagreement – although there should be no reason for this to be so, given that candidates in both parties share an interest in not being seen to be supporting illegal contributions – it is possible that the regulations could be delayed because of the provision of the Federal Election Campaign Act and related FEC rules¹³ providing that an affirmative vote of at least four Commissioners is necessary for the Commission to act.

Amendments to laws governing regulation of financial services

An alternative approach would be for Congress either to amend a specific law governing the regulation of financial services or to instruct an agency (most probably the FDIC, though it could presumably also by the CFPB) [CK] to close the loophole. This would have the virtue of tightening regulation of credit cards and is consistent with both the Government's and the card associations' interests against fraud; however, it could be subject to challenge on jurisdictional grounds, as some might argue that the proper venue for action lies with the FEC.

A role for political parties?

It would be quite helpful to close the loophole if the two major political parties could simply state that candidates for Federal office using their affiliations must follow all security protocols developed for the use of credit cards. This effort would be stronger if the relevant party committees (NRSC, DSSC, NRCC, DCCC) would state that they will not share funds with campaigns that do not meet this minimum standard to guard against illegal foreign contributions.

While these recommendations would not have the force of law, they could nevertheless serve as a useful interim measure until Congress or the FEC act.

At all events, it is time for campaigns for Federal office to ensure they are complying fully with Federal law – and this includes the use of standard industry anti-fraud protections to protect against the danger of illegal contributions from foreign sources. Only through this much-needed reform can Americans have the assurance (or at least greater assurance) that only Americans have contributed to the campaigns in which their Federal officials are elected.

This document was posted on the website of Take Back Our Republic on September 8, 2015 as the result of research designed to advance our effort to educate the public on potential conservative solutions to campaign finance reform. Questions can be directed to beatricet@takeback.org or by calling the non-profit's office at [334.329.7258](tel:334.329.7258).

¹² See generally, 5. U.S.C. §553 et seq.

¹³ <http://www.fec.gov/pages/brochures/fecfeca.shtml>