

Can Internet Gambling Be Effectively Regulated? Managing the Risks
By Dr. Malcolm Sparrow, Kennedy School of Government, Harvard University
Commissioned by WiredSafety

Summary

Study Background

- This new, comprehensive study of the risks associated with unregulated Internet gambling was commissioned by WiredSafety.org. WiredSafety is a 501(c)(3) charity and is the world's oldest and largest online safety, education, and self-help organization. WiredSafety works in four major areas: help for online victims of cybercrime and harassment; assisting law enforcement worldwide on preventing and investigating cybercrimes; education; and providing information on all aspects of online safety, privacy and security.
- WiredSafety also has a longstanding interest in gambling policy and the prevention of underage gambling. WiredSafety.org is headed by Parry Aftab, an international cyberspace privacy and security lawyer and children's advocate with extensive experience in gambling law and regulation.
- The principal author of the study is Professor Malcolm Sparrow, faculty chair of the Masters of Public Policy Program at Harvard University's Kennedy School of Government. A former SWAT Team commander and chief inspector with the British Police Services and a world renowned expert on regulatory policy, Dr. Sparrow reviewed the existing literature, evaluated current regulations and cutting-edge technologies, and interviewed regulators, researchers and public policy experts from around the world. Dr. Sparrow was supported by experts in technology and other relevant disciplines.

Approach and Major Findings

- The report doesn't advocate for or against legalized Internet gambling. Instead, it evaluates and weighs the different types and levels of consumer risks associated with existing, mostly unregulated Internet gambling against the risks associated with Internet gambling in a strictly-regulated environment.
- Notwithstanding the current prohibitionist legal and regulatory approach, the study cites evidence that millions of U.S. residents gamble online through offshore gambling sites. Indeed, the net effect of the current approach is to push Internet gambling underground and offshore, out of the reach of U.S. courts and regulators and exposing American consumers to significant risks.
- The United States therefore finds itself in the unfortunate position of incurring all the social costs of online gambling while having no control over the gaming sites that serve U.S. residents. The status quo offers no meaningful consumer protections. The current prohibitionist regime exposes consumers to a number of potential risks:
 - gambling by minors;
 - problem gambling;
 - fraud by operators;
 - fraud by players;
 - organized crime;
 - money laundering by players;
 - money laundering by operators;

- violation of jurisdictional prohibitions;
- breaches of data confidentiality; and
- lack of site security.
- The most fundamental and important conclusion of the study is that the legalization and regulation of online gambling would offer significant improvements to consumer welfare and protections related to each and every risk factor. That is, the best way to solve potential problems such as underage gambling and problem gambling is through strict and intelligent regulation, coupled with technology – not by trying to ban Internet gambling completely.
- On the basis of the research team's review of the existing literature, available technologies, and interviews with academics, regulators, industry participants, and public interest advocates, the study reaches three main conclusions:
 - Online gambling could be regulated effectively if it were legalized.
 - A well-structured regulatory regime should provide much better social and consumer protections than the status quo for all of the identified risks.
 - At a minimum, even an imperfect legalization and regulatory regime for online gambling would give Americans much more protection than they have now. The current prohibitionist policy is extremely weak: large numbers of U.S. residents already gamble online, but they do so using offshore sites, many of which are poorly regulated or unregulated.
- For each risk, the research identifies a set of regulatory methods and technologies that would provide appropriate risk management in a regulated environment. The report demonstrates that these regulatory tools and technologies already exist and have already been implemented in some form in many jurisdictions, including the United Kingdom, Alderney, Gibraltar, and other well-regulated jurisdictions, as well as across a broad spectrum of ecommerce activities.

Analysis of Selected Risks

- Let's walk though the study's analysis of some of the risks associated with Internet gambling that have been the focus of much of the related public policy debate.

Underage Gambling

- A common concern about legalizing online gambling stems from the fact that many current online gambling sites do not have adequate regulations or safeguards against gambling by minors. The primary concern is that underage access to and use of online gambling services might increase because it may be difficult to verify age and replicate controls used by bricks-and-mortar casinos to exclude minors.
- American young people are gambling on the Internet. According to the National Annenberg Survey of Youth, in the United States, card playing for money on the Internet by male youth aged 14 to 22 rose to 3.3% in 2008 from 2.4% in 2007.
- In contrast to unregulated sites that offer no protections against underage gambling, well-regulated overseas gambling jurisdictions require online operators to verify the identity, location, and age of their customers and to use various mechanisms to curb underage gambling.
- How does age verification work in well-regulated Internet gambling jurisdictions? Through strict regulatory requirements mandating a series of rigorous player identification

processes prior to establishing a new account. These regulatory requirements and processes offer excellent safeguards because the identities of adults can be validated through real-time automated crosschecks of existing databases that are not utilized in brick and mortar casinos.

- Age verification is part of a larger, step-wise process that builds a profile of the prospective customer. That is, age verification, identity verification, and cross checking against databases of unwanted persons (for example, the Specially Designated Nationals list maintained by the Treasury Department) are components in an integrated process that provides, for operators and regulators alike, a comfort level that each prospective customer is who s/he say s/he is, is of legal age, is located in a jurisdiction where the activity is legal, and is not otherwise barred from participation in regulated Internet gambling. Here's how the process typically works:
 - The first step takes place during the registration process and involves identifying a prospective customer's IP address and verifying that the customer is physically located in a jurisdiction that permits Internet gambling. Assuming that the customer's geolocation is verified and appropriate, an automated callback is made to the telephone linked to the address provided by the customer during the registration process, using a reverse lookup of phone records. The customer is asked during the callback to input on the telephone a verification number that is visible on the customer's computer screen. Successful completion of this process ensures that the customer is residing at the address provided and that the person is indeed seeking to open the account.
 - If the process is successful, then personal identification information provided by the customers is cross-matched against various government-maintained as well as commercial databases of undesirable individuals.
 - If the date of birth provided does indicate a customer is "of age" (the legislation now under consideration establishes 21 as the legal age), then the operator would use one or more independent data service companies (such as those now used to verify age and identity online for shipment of alcohol or tobacco) to test whether the name and address match the date of birth provided. These independent data service companies use a variety of specialized databases, including credit data, drivers license, and voter information to cross-reference and to verify the identity and age of the individual.
 - A failure to verify either age or identity would mean that the customer may not open an account. The customer may, however, have the option of providing physical copies of identifying records (such as a driver's license or passport) for further review by the operator.
 - Information such as the social security number provided by the customer would then be used to generate a list of personalized challenge questions (concerning, for example, previous cars registered, previous addresses, etc.), all of which the customer would have to answer correctly before an account is opened. Only if all of these steps are successfully completed can the operator permit a customer to open an account in a well regulated environment.
- While verification of the age of the customer when registering for play is accomplished by cross-matching government issued ID and other information customers supply using the specialized databases just described, a number of additional age verification tools are available to regulators. For example, a confirmation letter might be sent subsequent to the opening of an account to the address listed on government issued identification. This

process would be similar to that used when a PIN number is changed with an airline, or bank, that serves as a notification that an account has been opened.

- The report's bottom line on age verification and the prevention of underage gambling is that online gambling can effectively exclude minors when it combines cutting-edge technology with a strong regulatory regime.

Problem Gambling

- While the prevalence of serious gambling problems is stable at about one percent in most countries despite the expansion of gambling opportunities and the advent of new gambling technologies and devices (including Internet gambling), there is a concern that both unregulated Internet gambling as well as regulated Internet gambling could lead to an increase in problem gambling prevalence.
- The study evaluates a number of hypotheses suggesting that problem gambling might be exacerbated through legalization. The report concludes that neither the removal of legal prohibitions; the introduction of respected gambling brands; the round-the-clock availability of legal internet gambling sites; nor the easier flow of funds to legal gambling sites should be expected to increase the prevalence of gambling problems.
- The evidence demonstrates that Internet gambling is already widely available, already participated in by a large segment of society, and is not inhibited by attempts to limit transfers of funds to and from Internet gambling sites. Indeed, the activity has been driven underground to sites that offer few, if any, protections and safeguards related to problem gambling.
- In contrast, the report identifies a number of promising technologies and effective protections available in well-regulated Internet gambling jurisdictions, some of which are not available in even the best-regulated brick-and-mortar jurisdictions, including:
 - requiring operators to provide players with mechanisms to set their own betting limits or limit the deposits they make to their online gambling accounts;
 - requiring site operators to allow gamblers to self-exclude from participating in gambling with the operator;
 - permitting family members to petition to exclude a gambler from a website;
 - banning extension of credit to players; and
 - requiring operators to display prominent links to support and counseling services.
- The study cites compelling evidence from a large-scale study of Internet gamblers in a regulated environment in Europe that demonstrates that self-limiting features made possible by Internet gambling sites are effective. Indeed, the study provides perspective of problem gambling experts that the graphical and interactive structure of the internet provides a revolutionary opportunity to create informed consumers with access to a variety of information designed to encourage safe choices and discourage unsafe behavior.
- Similar to its findings on underage gambling, the report concludes that legislative restrictions have failed to prevent U.S. gamblers from engaging in online gambling and have perpetuated an environment that lacks responsible gaming features and safeguards and limits publicly funded resources to educate the populace about problem gambling. Regulators should be able to design sufficient protections to prevent any significant growth in problem gambling that results from legalization. Operators licensed within the United States should be required to offer a best-in-the-world range of services and resources for problem gamblers as well as to prevent underage gambling.

- The study also recommends that a proportion of the tax revenues and licensing fees derived from the U.S.-based industry could be used to substantially bolster the level of support for educational programs and services.

Enforcement of Jurisdictional Decisions

- States have traditionally determined what, if any, forms of gambling to permit in their borders. Right now, however, Internet gambling respects neither state nor national borders. Strict regulation, coupled with implementation of available technologies, would respect jurisdictional differences in decisions on access to Internet gambling.
- For the most part, respecting state decisions on opting in or out of regulated Internet gambling is a technical issue. And many geo-location systems and technologies are available to mitigate the risks of jurisdictional violations of state access laws.
- Geo-location entails using Internet infrastructure information to determine the geographic location of Internet Protocol (IP) addresses associated with Internet-connected devices. It is a way of determining the physical location of an Internet user, with varying degrees of accuracy. When an Internet user types a website address into a Web browser, the browser sends an access request to the server of the requested website. This request reveals the IP address of the user, which the requested website forwards to a geo-location provider. The provider, which has built a database of the locations of IP addresses, assesses the location of the user. Public-source geo-location data can often identify the location of IP addresses at the country, state, and even city levels.
- In a strictly regulated Internet gambling environment, geo-location technologies would be used to verify that a customer is in a permitted jurisdiction at the time of registration. They would also be used to verify that a customer is in a permitted jurisdiction during any particular session of play. Geo-location software can pinpoint the user's location and, if in doubt, flag it for site operators to either further investigate or block access immediately.
- Geo-location technology is already used for a number of purposes, such as restricting access to content, protecting media rights, and delivering location-based content to users. It is used by organizations such as the New York State Lottery, the British Columbia Lottery, Major League Baseball, and the Alaska Permanent Fund. It is also used to detect and deter fraud at online retailers by comparing the user's location with his or her credit card address, for example, and governments and law enforcement agencies use geo-location to help track Internet criminals.
- Some technologies to circumvent geo-location do exist (e.g., proxies, firewalls, Network Address Translators, and VPN). Geo-location software, however, can exploit the physical characteristics of an Internet connection, such as the round-trip delay, to detect these countermeasures and assign a "confidence factor," indicating the probability that the reported location is the user's actual location. Also, the software can determine if the destination address belongs to a cable company, a DSL provider, or a dial-up ISP. Thus, the destination can indicate the user's connection type and whether it is too risky to accurately verify the user's location. In these cases, the customer's account can be blocked completely from using the service until his or her location can be determined with greater certainty, or the site's compliance department can flag the account for further review. Further review could involve requiring the user to submit additional information, which then may be subject to manual or real-time verification.
- Regulators may impose specific requirements on the confidence of any geo-location

information, on the basis of the confidence factor determined by the software, in essence to “tune” the thresholds for acceptance, rejection, and further verification. For example, the New York Lottery and the British Columbia Lottery require nearly 100% confidence scores in order to allow users to participate in their respective lotteries. In this way, regulators can have as much assurance as they require in the geolocation system, making it an effective means of excluding individuals in any specific jurisdiction.

Money Laundering

- The current prohibitions related to online gambling forces players to use unconventional forms of payment that leave harder-to-follow audit trails, and may therefore increase the risk of money laundering. In addition, the lack of oversight and transparency for many offshore Internet gambling operations means that many operators of Internet gambling sites are not subjected to the kinds of licensing requirements that can prevent criminal infiltration of the industry. Therefore, the existing environment offers considerable opportunity for money laundering, although documented cases of money laundering related to Internet gambling are somewhat rare.
- In an effective anti-money-laundering regime, site operators would be required to retain comprehensive data on all deposits, withdrawals, and betting transactions and to make these available to regulators for examination and analysis. Given complete data, most patterns related to money laundering (such as light betting or matched bets placed by collaborators) would be easier to detect than they are in a physical environment.
- To prevent money laundering, regulators would subject online gambling operators to federal anti-money-laundering regulations that are currently in place for bricks-and-mortar casinos and for online merchants, banks, and payment providers. The online environment provides better opportunities for detecting money laundering by players or player groups than do bricks-and-mortar casinos.
- Software for detecting anomalies and suspicious behavior may be operated easily and routinely on digital databases by operators, regulators, or both. The site operators’ obligations with respect to their own detection of money laundering would form a part of their ordinary compliance obligations under such a licensing regime. Because of the absence of cash in online gambling transactions, the auditable record that is created, and the regulator-imposed reporting requirements for most transactions, it is likely that site operators can prevent money laundering by players and terrorist financing more effectively as can brick-and-mortar casinos.

Other Risk Analyses

- The report evaluated a number of additional risks associated with existing, unregulated Internet gambling and gambling in a strictly-regulated U.S. environment. For these risks as well, a regulated environment presents far more and greater consumer protections than the existing prohibitionist environment.
 - Cheating or defrauding of players by other players: Most of the cases of improper player collusion or cheating that have come to light have been detected by other players. With a regulator in place for U.S.-licensed sites, players would have stronger recourse against the sites, or against other players, by lodging complaints with the regulator or relevant law enforcement agencies. More important, licensed operators would be required to maintain comprehensive databases of all betting transactions and these databases could be examined and analyzed by regulators in the event of an inquiry or the triggering of red flags. Site operators, who themselves have a strong interest in maintaining the integrity

of their games, would be expected or even required to implement pattern recognition software to scan routinely for anomalous betting patterns.

- Fraud by operators and organized crime: These risks would be effectively limited by a regulatory strategy designed to keep the bar for admission high and to keep criminals out. Such controls have worked well in bricks-and-mortar casinos and would operate similarly with U.S.-licensed online site operators. Relevant tactics include rigorous vetting procedures for new applicants and monitoring of licensed site operator behavior to prevent or detect regulatory noncompliance, criminal conduct, fraudulent and deceptive practices, and disregard for consumers' rights.
- Breaches of data confidentiality: Under legalization and regulation, U.S.-licensed operators would be subject to all applicable federal and state requirements regarding data confidentiality and security. Site operators would be subject to regulatory and potentially criminal sanctions and civil liability for any breaches or abuses of personal or financial data. Their data-protection controls would be subject to regulatory audit. There is no reason to believe that licensed online gambling operators would be any less able or willing to fulfill these obligations than other online merchants with similar data custody obligations.
- Communications and computer security failures: Under the current regime, U.S. authorities have no oversight over security for online gambling sites. With legalization and regulation U.S. licensed sites would be subject to existing data protection laws. Furthermore, U.S. regulators would have an opportunity to require state-of-the-art cybersecurity controls to protect against the introduction of malicious code or the unauthorized manipulation of games.

Bottom Line

- If the United States decides to legalize and regulate online gambling sites, the study's authors expect most U.S.-resident gamblers to be diverted from overseas sites toward reputable and trusted domestic operators. In the long run, reputable gambling operations under U.S. control should come to dominate online gambling opportunities chosen by U.S. consumers.
- All categories of risk identified and evaluated in the report would be better controlled in such circumstances than they are at present. In the end, U.S. consumers would be better protected than they are now.