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Introduction:

Good morning Chairman Frank, Ranking Member Bachus, and distinguished members of the House Committee on Financial Services.

My name is Malcolm Sparrow, and I teach regulatory and enforcement policy and operational risk control, predominantly to government regulators, at Harvard’s John F. Kennedy School of Government. I have worked with a wide range of Federal and State regulatory agencies on the challenges of effective risk-control and social harm-reduction, and the use of various regulatory structures and practices in delivering improved public protection. My expertise is in regulatory policy and its relationship to risk analysis, rather than in any extensive prior knowledge of the gaming industry and gambling behavior per se.

Earlier this year, *WiredSafety* (the Internet safety and educational charity) commissioned a research report to help inform the legalization debate and to help educate the public on the risks associated with online gambling and the best ways to address those risks. The *Brattle Group* (a research and consulting firm) convened a team of experts to work on the report, and engaged me to participate as an expert in regulatory policy and practice.

The full report¹ was released yesterday, and I am happy to make it available to the committee as an addendum to my written testimony. I have summarized the major findings of the report in this written testimony, for your convenience.

Our analysis did not directly address whether online gambling should be legalized. In focusing on managing risks, we did not weigh moral or religious objections to gambling, nor did we examine broadly libertarian arguments in favor of allowing adults to engage in pastimes they may enjoy. We did not conduct any analysis to quantify the benefits of

¹ “Can Internet Gambling Be Effectively Regulated? Managing the Risks.” Sparrow, M.K., Bazelon, C. & Jackson, C. The Brattle Group, Washington D.C. December 2009.

potential tax revenues attributable to regulated online gambling. Further, we did not focus on any issues of federalism or on exactly where regulations and laws should fit into the U.S. multi-jurisdictional governance structure. Instead, we concentrated more narrowly on the obligations of government to protect citizens in general, and vulnerable groups of citizens in particular, from unnecessary exposure to harm.

We sought (1) to identify the specific risks that are associated with, or perceived to be associated with, Internet gambling; (2) to determine suitable regulatory strategies for controlling or managing those risks; and (3) to assess how effective those strategies are likely to be. We identified 10 distinct risks that fall into four broad categories. The four categories are as follows:

- Gambling by minors
- Criminal and fraudulent behavior
- Network access, data privacy and security
- Problem gambling

On the basis of our review of the existing literature and interviews with academics, regulators, industry participants, and public interest advocates, we came to the following 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 the risks we identified.
- 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 of the 10 risks we examined, a set of regulatory methods and technologies exist that would provide a reasonable degree of control, and most of them have been implemented effectively in other jurisdictions or in other online settings.

Although some controls used in the bricks-and-mortar environment may not translate to online gambling environments, several of the risks we examined become *more* amenable to control online. Comprehensive electronic records and the ability to track financial transactions and betting patterns provide more opportunities for analysis and audit, and hence improve the chances of discovering fraud or criminal activity. They also allow gambling websites to provide tools to mitigate problem gambling in a timely manner.

Our research approach has been to analyze each of the specific risks that are perceived to be associated with Internet gambling and then determine how best to control or manage them. Those ten specific risks are listed below:

A: Gambling by Minors

1. Gambling by minors: There is concern that minors might find it easier to access and use online gambling services in a legalized environment.

B: Criminal and Fraudulent Behavior

2. Defrauding of consumers by site operators: There is the possibility that online site operators could rig games, refuse to pay out winnings, or simply vanish taking with them players' account balances.
3. Cheating or defrauding of players by other players: There is a concern that players could collude to defraud others, particularly in online poker. Online gambling may offer opportunities for collusion that are not available in a physical environment with visual surveillance.
4. Involvement of organized crime in gambling operations: Organized crime has a history of involvement with the bricks-and-mortar casinos and is now involved in some online commerce. There is some concern that involvement in the online gambling industry may be a natural next step.
5. Money laundering by players: There is concern that players or groups of players acting in concert could use legitimate gambling operations for money laundering.
6. Money laundering by site operators: The possibility has been raised that site operators could use online gambling operations, with its significant financial flows, as a cover for money laundering on a large scale.

C: Network Access, Data Privacy and Security Issues

7. Violation of jurisdictional restrictions or prohibitions: Government at the state, local, and tribal levels has traditionally exercised control over gambling within a given jurisdiction. The advent of the Internet has opened the question as to whether controls mandated by any proposed laws can be enforced within particular jurisdictions.
8. Breaches of data confidentiality: To register for play, players surrender personal or financial data to site operators. Consumers might be harmed by deliberate or accidental breaches of the confidentiality of those data.
9. Communications and computer security failures: Some are concerned that site operators might not use appropriate security procedures and technologies to ensure the integrity of their sites. Absent proper security measures, malicious code could be transmitted to players' computers, game operations could be infiltrated, and intrusions into the systems could compromise the game play and security of users.

D: Problem Gambling

10. Problem gambling behaviors: Some argue that increased opportunity to gamble at any time, from anywhere, and at a faster pace might exacerbate pathological, addictive, or problem gambling behaviors.

With respect to each of these ten types of risk, we sought to answer three broad questions:

1. In the existing prohibitionist legal and regulatory regime, what level of protection are U.S. consumers afforded?
2. With legalization, could these risks be addressed more effectively than they are now, and assuming legalization, what regulatory strategy is best suited for addressing these risks?
3. What are the potentially relevant technologies and methods available for effective risk mitigation, and how might other parties contribute toward effective control?

Our answer to the threshold question of whether online gambling can be effectively regulated came out of our analysis of these more specific questions.

The Status Quo Offers No Effective Protection

Many U.S. residents already use online gambling services despite statutory restrictions. Recent estimates indicate that U.S. gamblers constitute roughly one-fourth to one-third of the global market for online gambling services. The size of the U.S. share of that global market was estimated to be \$5.9 billion in 2008.

The mainstay of the current prohibitionist regulatory structure is the Unlawful Internet Gambling Enforcement Act (UIGEA). Instead of criminalizing gambling itself, the UIGEA was intended to prevent U.S. residents from gambling by placing restrictions on the role of financial institutions in transmitting payments to and from gaming operators. However, because workarounds such as e-wallets (essentially a payment processor situated between banks and gambling sites), phone-based deposits, and prepaid credit cards have proliferated, very few U.S.-based gamblers are presently much inconvenienced. Most gamblers are either unaware of or confused by the patchwork of federal and state restrictions, and many are readily guided by unregulated online gambling sites toward financial mechanisms that they can use to make deposits and withdrawals.

The net effect is that the U.S. attempt to prohibit online gambling has instead pushed it offshore. Sites are readily available to U.S. residents through the essentially borderless medium of the Internet. Some sites are well-regulated, such as those based in the United Kingdom, Alderney, and Gibraltar, and others are less-well-regulated or unregulated, such as those in Antigua, Grenada, or the Kahnawake Mohawk territory. (Of course, it is the less-well-regulated international sites that provide easier access to U.S. consumers.) As a result of the global gaming industry's adaptations to the U.S. strategy, the United States finds itself in the unfortunate position of

- incurring all the social costs related to U.S. residents' online gambling;
- exercising no jurisdiction or control over the gaming sites that serve U.S. residents;

- being unable to offer U.S. residents who choose to gamble on overseas sites any consumer protections or to implement any other harm-reducing strategies; and
- being unable to qualify industry participants or even exclude criminal groups from competing for U.S.-based customers.

Legalization and Regulation Would Afford Significantly Better Protection than the Status Quo

At a minimum, legalization and regulation of online gambling would give Americans much more protection than does the current prohibitionist regulatory framework. Although the kind of regulation that would accompany legalization would not be failsafe, it would be a significant improvement over the current regulatory and enforcement structure. We believe that safeguards could be implemented that would, on balance, substantially improve protections against the identified risks. These safeguards would also provide protection equal to or greater than that provided within the U.S.-based bricks-and-mortar gambling industry. We recognize that no set of technical or regulatory controls could ever eliminate these risks entirely. But even if the new fence had a few holes, it would be an improvement over having no fence at all.

The view that online gambling, in contrast to its bricks-and-mortar casino counterpart, is impossible to regulate reflects an old-fashioned perception of cyber jurisdictional authority. Many offshore commercial entities that operate online are subject to U.S. legal jurisdiction under existing long-arm statutes and authority. When coupled with governmental licensing authority, the ability to police online activities is even more powerful. Legalization with regulation would provide U.S. authorities with the power to grant or deny licenses and to impose significant sanctions on noncompliant licensees. Those licenses would be highly valuable to site operators. Compliance with any regulatory requirements and strict licensing conditions that Congress chooses to impose in return for the privilege of the license would therefore become a core business imperative for the gaming industry.

Just as with bricks-and-mortar casinos, the requirement for site operators to maintain a license gives the government the ability to exclude bad actors as well as impose a broad array of conditions for, and oversight of, licensees. In contrast, the current prohibitionist policy is extremely ineffective: large numbers of U.S. residents already gamble online, but they do so using offshore sites, many of which are poorly regulated. With legalization, we would expect that most online gamblers would prefer licensed U.S.-based sites because of their integrity and security, rather than accept the risks posed by unregulated or poorly regulated sites. A well-structured regulatory regime would provide better protections against all of the risks we identified.

This conclusion is supported by the experience of other jurisdictions in regulating online gambling. Some of these, such as the United Kingdom and Alderney, have adopted regulatory regimes that appear to provide protection against the identified risks. That may be the most compelling evidence that online gambling can be effectively regulated.

Regulatory Methods and Technologies for Controlling Each Type of Risk Already Exist

For each of the 10 risks we examined, a set of regulatory methods and technologies already exists that would provide a reasonable degree of risk management. Moreover, most of them have been implemented in other countries. One general insight from regulatory policy, and a review of other country's experiences, is that no one size fits all: regulators should treat different risks differently. The incentives and motivations of different parties vary across risk categories, as does the locus for detection and control interventions. Understanding the natural incentives of the gaming industry with respect to each class of risk reveals whether a cooperative regulatory strategy would likely be more effective than a traditional enforcement-centric one.

For example, for at least one of the risks we identified (protecting the integrity of poker games by preventing players from colluding or conspiring to cheat other players), the interests of the public and of the gaming industry align reasonably closely. Both groups are interested in ensuring the integrity of the games. That makes a more cooperative and less adversarial regulatory relationship quite natural.

For other risks (such as defrauding of consumers by site operators, involvement of organized crime, and money laundering by site operators), a strict enforcement regime focused on identification and rapid exclusion of bad actors is more obviously appropriate. Oversight in these areas would focus heavily on up-front qualification or "suitability" to exclude those with criminal histories or connections and persons otherwise lacking in "good character, honesty, and integrity" as is the case in the bricks-and-mortar space. Enforcement activity would focus on bad actors, with the goal of exclusion and sanction. The intense and strict monitoring regime for reputable sites would include provisions designed to prevent or reveal any infiltration over time by undesirable groups or influences. Such regulations would mirror those now in place for bricks-and-mortar casinos.

Reputable sites, whose competitive advantage lies substantially with their reputation for integrity, would not be much troubled by the type of oversight designed to keep the "good character, honesty, and integrity" bar for admission high and the bad players out. In fact, they should appreciate such oversight as a positive contribution to the overall public perception of their industry, and the regulatory certainty provided by a licensing model would help with the industry's overall long-term planning.

Some risks (gambling by minors, money laundering by players, problem gambling, breaches of data confidentiality, and lack of site and technology security) present more complex challenges in terms of regulatory design. If site operators were driven solely by their short-run economic incentives, they would more likely take bets from minors, problem gamblers, and money launderers (because the sites gain financially, at least in the short run, from all such bets), and they might limit their investments in data privacy and security. Site operators might also gain, in the short run, from abusing or selling personal and financial data provided to them by gamblers.

In the longer term, of course, site operators value their brand names and reputations matter, and these five risks all figure as *reputational risks* from the industry's perspective just as they do in the bricks-and-mortar gambling industry. By setting the admission bar for licensees suitably high, U.S. regulators would intend to admit only reputable operators, whose behaviors would be guided by the value they place on establishing and maintaining a trusted brand. This is the approach taken by regulators in other jurisdictions—license only reputable firms. Probity investigations are conducted into the companies and their associates before a license is issued. Hence, for these five risks, close supervision would be required if an operator were regarded as a rational but short-sighted actor. At the same time, a more cooperative and symbiotic regulatory relationship ought to emerge when reputable operators take a longer-term, strategic view. To better align site operators' short- and long-term interests, regulation also would provide for sanctions, from monetary fines up to and including loss of license for those site operators that choose to disregard mandated operational and consumer protections.

One strategy to provide longer-term, reputation-based incentives for good behavior is to create costs to entry—through the regulatory process, licensing fees, or other means—that reduce incentives to make a quick profit and leave the industry. For all risks created by operator shortsightedness, regulators need to establish and retain sufficient audit and monitoring systems so they can see when organizations that are otherwise reputable tilt too heavily toward short-term gain at the expense of public protection. Regulators should not accept the industry's protestations that they can be entirely trusted to take care of such risks without oversight simply because it is in their interest to do so. It is indeed in the industry's long-term interests to do so, but short-term considerations sometimes prevail, even in major corporations and multibillion dollar industries.

The following sections of this white paper describe a variety of control technologies and regulatory tactics relevant to each risk, and identify the most promising approaches in each case. Table 1, attached to this testimony, lists the 10 risks and for each outlines

- the level of protection afforded under the current regime (column 2);
- the overall structure and style of regulatory oversight most natural for each risk (column 3), and
- some key points regarding relevant technologies and control strategies (column 4).

Here I shall summarize some key points in relation to each risk.

A: Gambling by Minors

There is a general concern that underage gamblers may access or attempt to access online gambling sites.

- Gambling by minors: A number of technologies routinely used in other industries can be used to exclude minors from online gambling, including a

variety of data-matching techniques, electronic or other submission of documentary evidence of age, and possibly application of biometric identification systems. The strongest form of control would require positive matching of a player at the time of registration against existing databases of known adults, thus excluding minors, as well as identity-verification prior to initiating any session of play. U.S.-licensed operators would be expected to use filters and procedures that are as discriminating as reasonably possible. With respect to U.S. residents, we would expect available data needed for age-verification to be of high quality and reliability. Site operators could also be required to provide child-protective software for parents to help prevent minors from accessing gambling sites. Alternatively, a separate governmental or nonprofit entity could provide such software.

B: Criminal and Fraudulent Behavior

Criminal activity can stem from site operators or the players themselves. The following risks are related to criminal activity by site operators:

- Defrauding of consumers by site operators,
- Involvement of organized crime in gambling operations, and
- Money laundering by site operators.

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.-based 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.

Regulatory strategy with respect to these risks would be enforcement-centric with a focus on excluding operators with criminal histories or connections. Reputable site operators with brands to protect could not afford to risk damage to their reputations, loss of their licenses, or regulatory sanctions. Thus, we would expect the industry at large to support the type of demanding admission standards, regulatory monitoring, and sanctions designed to keep bad actors out of the business. Players, best positioned to detect improper conduct or consumer fraud by site operators, would be enabled and encouraged to report site operators' improper conduct directly to regulators and others in law enforcement. Players would also have access to U.S. courts for dispute resolution.

Player criminal behavior falls into two major categories—cheating or defrauding of players by other players and money laundering by players.

- 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 could 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, could be expected or even required to implement pattern recognition software to scan routinely for anomalous betting patterns.
- Money laundering by players: Online gambling operators, like operators of bricks-and-mortar casinos, would be subject to current anti-money-laundering regulations. These regulations would require site operators to expend some level of effort in detecting money laundering. The online environment provides *better* opportunities for detecting money laundering by players or player groups than the bricks-and-mortar casino environment. Site operators could be required to retain comprehensive data on all deposits, withdrawals, and betting transactions and to make these data 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 (where complete transaction histories are available only in the form of video recordings). Software that detects anomalies and suspicious behaviors could be operated easily and routinely on digital databases by the site operators, by regulators, or by both. The site operators' obligations with respect to their own detection of money laundering would form a part of their ordinary compliance obligations under the licensing regime.

C: Network Access, Data Privacy and Security Issues

Any U.S. legalization and regulatory regime would likely address the risk of access to online gambling sites from jurisdictions that prohibit such activity.

- Violation of jurisdictional restrictions or prohibitions: State, local, and tribal governments may continue to prohibit or restrict (1) the operation of gambling sites from within their jurisdictions and (2) online gambling by individuals resident or physically present within their jurisdiction. Licensed U.S. sites could be required to take all reasonable steps not to permit registration or participation by individuals in such states. A range of geolocation technologies are now available, mostly tied to identification of the user location by reference to their IP addresses. Such technologies, while not entirely foolproof, have the capability of reducing risks as much as is required by regulators. IP geolocation, together with address verification at registration and other controls, can be expected to deter the bulk of casual attempts to gamble from within restricted states. Determined users, of course, already have access to foreign sites and would probably continue to use

those rather than go to the trouble of devising sophisticated technological means for defeating U.S.-based geolocation controls. Regulatory oversight methods could include audits of U.S.-based operators' software controls and routine "mystery shopping" at U.S. sites conducted from locations within states that had chosen to exercise their rights to restrict online gambling.

Data privacy and security risks include: sites not using commercially appropriate security systems and practices; intentional or accidental breach of the gambling site's and user's data security; and the introduction of spyware, adware, or malicious code into gambling websites' software or transmission of such malware to users' computers.

- 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.

D: Problem Gambling

It is relatively easy to demonstrate for the other risk categories that a well-structured regulatory regime coupled with relevant technologies should provide better protection than the status quo. For problem gambling, however, the potential effect of legalization is less obvious a priori. Many might assume that pathological or addictive gambling behaviors would be exacerbated by the increased opportunity to gamble at any time and from anywhere online. But research on this topic does not support this conclusion. In particular, the link between the availability of online gambling and increases in the prevalence of problem gambling has not been established. Nevertheless, some online gamblers would be problem gamblers.

In a well-regulated online environment, gamblers could have opportunities and technologies made available to them to help curb addictive or problematic gambling behaviors. Such mechanisms would permit them to limit their gambling volume, deposit rates, loss rates, and the size of each wager. Users could also access online clinical and self-help resources from links provided at the gambling site.

The relationship between legalization and potential effects on problem gambling rates must certainly be examined carefully. Opponents of legalization fear an increase in problem gambling rates. However, gambling experts in the United States and the United Kingdom have reported that the prevalence rates for pathological gambling have remained static and low (roughly 0.7% of the adult population, in both countries) for many years. A large-scale study of gambling prevalence in the U.K. found the 0.7% rate remaining stable from 1999 through 2007 despite substantial increases in gambling opportunities during this period.

Because this issue is likely to receive considerable attention as the United States considers legalization, we have attempted to analyze the various arguments given as to why the act of legalization might drive the level of problem gambling up or down. We have identified five popularly discussed mechanisms through which legalization could drive problem gambling *up*, and describe them here along with some observations that help mitigate the anticipated effects:

- Mechanism: Inhibitions to gamble that are based on would-be gamblers' knowledge of current legal restrictions would be removed.
 - Observation: Gamblers in the United States are generally ignorant of or completely confused about existing legal restrictions, and (until very recently) there has been no enforcement against the gamblers themselves. Hence, the lifting of the prohibition itself is unlikely to have any significant impact on would-be gamblers' willingness to gamble online.
- Mechanism: Gamblers may be more comfortable gambling online because licensed operators are reputed to be trustworthy.
 - Observation: The gamblers most likely to be influenced by the availability of trusted brand-name sites are those who gamble already, perhaps in the casino environment, and hence know the brands. Knowledgeable gamblers may indeed shift their business, but this represents displacement, not overall growth. And the displacement would be from bricks-and-mortar to online gambling, which can offer many more options and protections for problem gamblers than can land-based casinos.
- Mechanism: Gambling opportunities would be ubiquitous and available 24/7.
 - Observation: U.S. residents already have online gambling options available to them all day, everyday, and from anywhere. So the addition of U.S.-licensed sites would not alter that particular reality.
- Mechanism: Lifting the UIGEA's restrictions on financial transactions might make it easier for consumers to place bets online.
 - Observation: Lifting the restrictions of the UIGEA would not make it significantly easier for U.S. residents to make deposits to online sites. Enough workarounds have been designed, and are energetically promoted to consumers by the offshore sites, to render the existing restrictions largely ineffective.

- Mechanism: Advertising by licensed online gambling sites might lead to increased problem gambling.
 - Observation: Although advertising is one avenue for the expected increase in online gambling that would follow legalization, little evidence exists to show whether and to what extent advertising-induced growth in, or redistribution of, gambling volume might produce increases in problem gambling rates. Furthermore, this mechanism (allowing advertising for online gambling sites) is controllable to the extent deemed necessary or desirable, through regulatory restriction.

We also looked at two mechanisms through which legalization and regulation could drive problem gambling *down*:

- Mechanism: Tax and license-fee revenue distributions may provide an opportunity to extend and enhance counseling, treatment, and support programs for problem gamblers.
 - Observation: Significant tax revenues might be anticipated from U.S. operators, and revenue distributions from taxes and license fees could substantially boost publicly funded prevention, counseling, and treatment programs, as well as research on gambling addiction. Existing budgets for counseling and treatment services for problem gamblers have been limited, and most health insurance programs do not currently cover these services.

- Mechanism: Regulators could require licensed domestic sites to lead the world in offering a full suite of advice and protections for problem gamblers to an even greater extent than is the case in bricks-and-mortar casinos.
 - Observation: U.S.-licensed sites could be required to display offers of help prominently on their websites, including (1) registration pages that offer self-diagnostic tests designed to help would-be gamblers understand their own attitudes and vulnerabilities; (2) web pages that display prominent links to support and counseling services; and (3) availability of speed-of-play, compulsory time-outs, or player-loss-rate caps. All players should be offered the opportunity up front and at subsequent intervals to voluntarily exclude themselves or to limit their own deposit rates, loss rates, betting rates, or periods of play.

We believe that the opportunities to mitigate problem gambling provide significant benefits not available under the status quo. These benefits provide a significant counterweight to any potential increases in problem gambling that result from legalization. Furthermore, the potential benefits of mitigation would become available to most existing online problem gamblers.

Conclusions

Our study examined 10 distinct risks in four categories that may be associated with the growth and availability of online gambling. In each case, the current legislative framework is failing to provide any effective risk control or consumer protection. The establishment of a well-regulated industry under U.S. jurisdiction would offer the opportunity for much better protection. We recommend that plans for regulating online gambling include the design and use of different risk-control strategies for different risks that may be associated with Internet gambling, as well as education and consumer support.

If the United States decides to legalize and regulate online gambling sites, we would 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 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.

I am happy to assist the committee in any way I can.

Thank you, Mr. Chairman.

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TABLE 1: Major Categories of Risk Related to Online Gambling

	<u>Category</u>	<u>Existing Protection</u>	<u>Natural Regulatory Structure & Strategy</u>	<u>Relevant Controls & Technologies</u>
1.	Gambling by minors	No effective protection. Offshore sites range from well regulated to completely unregulated.	Industry's short-run incentives: <i>supervisory</i> . Industry's long-run/strategic view: <i>cooperative</i> .	(Strongest form) Positive id matching at player registration against existing databases of known adults. Range of weaker forms of age verification available at player registration. Provision of child-protective software for parents, to keep minors off their parents' accounts.
2.	Consumers defrauded by site operators	No effective protection. Offshore sites range from well regulated to completely unregulated.	<i>Supervisory</i> : Enforcement focus aimed at disreputable operators. Exclusion of bad actors.	Vetting applicants and monitoring existing licensee behavior. Licensee oversight that includes software audits, mystery shopping, and betting pattern monitoring by regulator. Available complaint procedures: players report directly to regulators and have access to U.S. courts.
3.	Players cheated by other players	Detection mostly by other players. Remedies unavailable if sites deny the problem.	<i>Naturally cooperative</i> : Public and industry's interests both served by preserving integrity of games.	Comprehensive data retention by sites. Routine operation of pattern recognition systems for anomaly detection. Complaint procedures available for players to report anomalies to operators and to regulators. Regulatory oversight of complaint investigation and disposition.
4.	Involvement of organized crime	No effective protection with respect to offshore activities.	<i>Supervisory</i> : Enforcement focus aimed at disreputable operators. Exclusion of bad actors.	Vetting applicants and monitoring existing licensees/operators for · criminal backgrounds, · criminal associations, and · hidden ownership interests.
5.	Money laundering by site operators	Offshore operations subject to international cooperative enforcement efforts.	<i>Supervisory</i> : Enforcement focus aimed at disreputable operators. Exclusion of bad actors.	Vetting applicants and monitoring existing licensees/operators for · criminal backgrounds, · criminal associations, and · hidden ownership interests.
6.	Money laundering by players	No effective protection.	Short-run incentives: <i>supervisory</i> . Long-run/strategic view: <i>cooperative</i> .	Anti-money-laundering laws apply. Comprehensive data retention by sites. Details of every transaction recorded (not possible in casinos). Pattern recognition · by operators as part of a compliance operation, and · by regulators as part of oversight audit operation.

TABLE 1 (continued): Major Categories of Risk Related to Online Gambling

	<u>Category</u>	<u>Existing Protection</u>	<u>Natural Regulatory Structure & Strategy</u>	<u>Relevant Controls & Technologies</u>
7.	Violation of jurisdictional restrictions or prohibitions	No effective protection. States have no remedy with respect to offshore sites.	Short-run incentives: <i>supervisory</i> . Long-run/strategic view: <i>cooperative</i> .	Right of government to prohibit or restrict · operators within state, and · services offered to residents by operators outside of state. Federal regulation of licensees that obliges them to respect list of state exclusions/restrictions. Residence validation at player registration. Geolocation monitoring for each player session (e.g., by ISP analysis). Regulatory audits of operators' software controls. Mystery shopping/testing by states exercising rights to restrict. Federal and state remedy against licensed operators through federal or state law.
8.	Breaches of data confidentiality	No effective protection. Offshore operators outside U.S. jurisdiction.	Short-run incentives: <i>supervisory</i> . Long-run/strategic view: <i>cooperative</i> .	Licensees subject to all U.S.-based requirements regarding data confidentiality. Licensees subject to criminal sanctions and civil liability for breaches/abuses. Data-protection controls subject to audit.
9.	Communications and computer security failures	No effective protection. Offshore operators outside U.S. jurisdiction.	Short-run incentives: <i>supervisory</i> . Long-run/strategic view: <i>cooperative</i> .	Principal responsibility for state-of-the-art security should rest with site operators. Civil liability for site operators with respect to any harm to consumers. Regulator's role in auditing site security software/systems.
10.	Problem gambling behaviors	No effective protection. Offshore sites range from well regulated to completely unregulated.	Short-run incentives: <i>supervisory</i> . Long-run/strategic view: <i>cooperative</i> .	Site-imposed limitations & controls. Self-imposed exclusion options. Self-imposed limiting options. Taxes and license-fee revenue distribution can extend & enhance counseling & support services.