

UNITED STATES NATIONAL GAMBLING IMPACT STUDY COMMISSION.

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Panel:- Internet Gaming Enforcement Issues: National and International Implications.

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BACKGROUND:

In Australia regulation of gambling is a function of the "State" level of government. The Victorian Casino and Gaming Authority is the Government body charged with gambling regulation in the State of Victoria. The Authority in conjunction with gaming regulators from each of the other Australian States and Territories and New Zealand has formed the Australasian Gaming Regulators Association. One of the association's main purposes is to develop policy options on a cooperative basis for consideration by the individual State, Territory and New Zealand Governments. The focal point of "Government" in each State and Territory is the relevant Cabinet Minister with responsibility for gaming. Gaming Ministers also meet, approximately yearly, to discuss issues of multi-jurisdictional significance at the political level.

Since 1995 the association and Gaming Ministers have been examining issues related to "interactive" gambling using new telecommunications technologies such as pay TV (new to Australia) and more recently the internet. The policy development has been carried out by a working party of Senior Officials from the various gambling regulatory bodies in each Australian State and Territory. I have had the task of chairing that working party since its inception in 1995.

A working party report entitled "Draft Regulatory Model for Interactive Home Gambling" was released by Gaming Ministers in May 1997 for community comment. The report recommended taking a regulatory, rather than a prohibitive, approach to interactive gambling. A copy of the report has been provided as part of the background material.

I must emphasise that any my testimony is made in the role of Chair of the multi-jurisdictional working party and not as a representative of the Victorian Casino and Gaming Authority or of the Victorian Government. I say this as the current position in Victoria is that the Government has given endorsement "in principle" to regulating internet and other interactive gambling as part of the cooperative National regulatory model proposed by the working party. This endorsement is subject to the drafting of "suitable" legislation for consideration by Parliament. Only if that legislation is passed will the Authority's have a regulatory role or can it be said that a regulatory, rather than a prohibitive approach, is the official position of the Government of Victoria.

To date, one Australian State, Queensland, has passed legislation with the objective of giving effect to the proposed regulatory model. A copy of Queensland's "*Interactive Gaming (Player Protection) Act 1998*" has also been provided in the background material.

The Commission's letter of invitation requests testimony on seven specific questions:-

- What are the jurisdictional obstacles posed by regulation or prohibition of this activity?;
- Why has Australia elected to regulate this activity?;
- How is the Victorian Casino and Gaming Authority proposing to enforce regulations upon Internet gaming operators?;
- What advantages/disadvantages does Internet technology offer over traditional forms of gambling in terms of enforcement?;
- What does the Australian regulatory regime require of Internet gaming operators in regard to accepting bets from players residing outside of Australia where the activity may be illegal?;

- Can prohibition of this activity in the United States be enforced upon an Australian company?;
- How is the industry expected to change as a result of being regulated in Australia?

In order to stay within areas that the Commission has expressed an interest only those specific questions will be dealt with in this written testimony.

WHAT ARE THE JURISDICTIONAL OBSTACLES POSED BY REGULATION OR PROHIBITION OF THIS ACTIVITY?

Internet gambling challenges current gambling regulatory models because what characterises almost all current gambling control models world wide is that they are directed at destination gambling.

In legalising destination gambling of all forms it has been some comfort to the public policy makers that players had to leave home to participate. Having to make the effort of going to the betting shop, gaming machine venue or casino is a deliberate and considered decision rather than an impulsive one that occurs on the spur of the moment if a product is consistently "in your face" as you go about your usual business or home activities.

Destination gambling has been around for centuries and regulatory structures for destination gambling are generally strict and achieve their intended aims. As regulators we have built all of our controls upon there being a physical location where the player and the gambling provider exchange information or money. This gives us a place where we can intervene and influence the operation of the product. By controlling the place where the product is offered we have been able to -

- control the type of site at which the product is offered, eg newsagents for lotteries, betting shops, clubs, hotels, casinos, etc
- control the availability of the products to minors by simply excluding minors from the location
- control the general availability of a product eg by limiting the number of sites, the number of gaming machines per site or even by limiting the total number of gaming machines throughout a State
- protect providers from competition and thus allow collection of monopoly rent taxes
- control the actual products offered through approving the rules of the game and player return percentages
- control the location of Automatic Teller Machines.

However, the internet is "virtual" and unlike destination gambling it does not provide regulators with a place where it is easy to intervene between the player and the provider. It is also run on infrastructure that is regulated by a different level of Government.

In Australia, the Federal level of Government is responsible for telecommunications regulation. Officers of the Federal Department that regulates telecommunications have made it clear that, in their view, internet connection providers should not be made responsible (liable) for content that they are acting only as a conduit for - as opposed to content which they provide. Accordingly, in Australia at least, it is not anticipated that internet connection providers will not be charged with the role of "gatekeeper" or "filter" for undesirable content.

In embracing the internet as an important means of transacting commerce and delivering information in the future, which is certainly the public position of the Governments of the United States, Australia and most other developed countries, is to recognise that undesirable content will be available from locations that have different standards to the receiving country. Whilst responsible governments can ensure that undesirable content is not provided from servers located within their jurisdiction (or that all potentially undesirable content is at least "labelled") individual users, at their personal computer, who choose not to use (or who can disable) content filters (such as PICS, NetNanny etc) will be able to gain access to sites with what public policy makers consider as undesirable content.

Accordingly, the greatest obstacle is for regulators to find a way to deal with a situation where gambling products can be delivered over a telecommunication network that has no cognisance or recognition of State borders or local rules. To do this, policy makers must accept that if gambling products are out there somewhere on the internet people will, if they want to, be able to get access to it.

In summary, as gambling controls have been traditionally directed at destination gambling, regulators have to adapt to a situation where our traditional controls are rendered inoperable. The internet environment certainly presents new challenges to Governments that consider that, in the public interest, they have an obligation to regulate particular activities carried out in the homes of their residents.

WHY HAS AUSTRALIA ELECTED TO REGULATE THIS ACTIVITY?

As indicated in the introduction at this point in time, except for one Australian State, it can not be definitively said that "Australia has elected to regulate". With the Commission's indulgence the question will be modified to "Why did the working party of regulatory officials recommend a regulatory approach?"

The model proposed by the working party recognises that regulation provides the best response to illegal gambling. Historically Australia's answer to illegal or offshore gaming opportunities has been to provide trusted, well regulated products as an alternative.

Policy makers in Australia have long held a general belief that illegal gambling is susceptible to organised crime. One of the reasons behind legalising the extensive range of legal products available in Australia has been to substitute the demand for the illegal product and reduce the presence of organised crime. In every instance in Australia, and this is not necessarily the case elsewhere, when the regulated lottery, bookmaking, totalisator, gaming machine and casino have been introduced the illegal form of the product has retreated to a level of insignificance.

It is important to note that the model does not pretend that walls can be put up against the global nature of the internet. If you are in Australia and you are logged on you will have the choice of either Australian provided products or overseas provided products. However, there will be in place controls to stop the "local" advertising or marketing of products offered outside of the model. ("Local" being the traditional advertising mediums of newspapers, television, magazines, radio etc offered within that jurisdiction.)

The model recognises that internet gambling is already here and that the current internet gambling sites are offered by people whose probity has not been subject to the tests that apply to regulated Australian operators and their games have not been subject to the intense technical testing applied by regulators of the Australian industry. Accordingly, Australians accessing these sites might:-

- be dealing with criminals or the criminally influenced,
- be playing games which are rigged and
- never be paid if they win.

A further and significant threat (of not regulating) is to the high standards set by Australian gambling regulators, particularly in the area of technical standards and game fairness criteria. Australian standards are second to none in the world of gambling regulation and if Australia lets anyone else set the eventually accepted standards for internet gaming then those standards can only be lower than now applies within the current Australian gambling industry. This in turn will potentially undermine the high standards currently achieved.

The working party also recognised that the internet provides Australian gambling providers with a number of opportunities to develop and expand their customer and product base into the "global" marketplace. This opportunity is enhanced by Australia being at the forefront of gambling technology and gambling regulation.

The working party believes that a number of Australian States have the regulatory experience with technology based gambling products to set up a regulatory control regime for internet and interactive gambling that players will trust. Embarking on a trail of prohibition in the working party's opinion can only prove ineffective. Accordingly, a window of opportunity exists for proactive providers to grab and maintain a large slice of the world pie. If Australia's current and future gambling providers are prepared to back themselves in the global marketplace the potential market is many times that currently achieved providing their products within Australia.

Further, most Australian jurisdictions, in particular Victoria, have an established reputation in regulating technology based gambling products. Examples of this include the locally developed technology required to provide the world's largest wide area linked gaming machine jackpot system. This system features a level of technology not yet matched anywhere else in the gambling world.

Interactive gambling products offered from participating Australian jurisdictions will have the credibility of being regulated effectively with guarantees on the integrity of the games and the provider and a regulator to investigate complaints and settle disputes.

The recommended approach is not to attempt to prohibit access to overseas products but to provide an Australian based product that Australian and overseas players will trust.

HOW IS THE VICTORIAN CASINO AND GAMING AUTHORITY PROPOSING TO ENFORCE REGULATIONS UPON INTERNET GAMING OPERATORS?

As there is no legislation yet in Victoria this question will be answered from the perspective of how the working party recommended achieving internet gaming regulation.

There are three levels in the regulatory structure: 1 cooperation, 2 incentives and disincentives and 3 licensing and product controls.

COOPERATION

A cooperative approach by all (or at least most) Australian States and Territories is seen as a key plank in the effective regulation of internet gambling products. This is both in terms of regulating licensed providers (and granting "mutual recognition" to each others providers and products) and in putting in place suitable disincentives for unlicensed or foreign products.

A non-cooperative approach would see individual States and Territories maintaining barriers to interstate products and discounting taxation rates in competition with other State Governments. In the short term this will limit the ability of Australian based service providers to effectively market their products to a critical mass of consumers and provide advantages to overseas based providers. In the long term a non cooperative approach can only result in the ineffective regulation of interactive gambling products and erosion of the gambling taxation revenue of all States and Territories.

INCENTIVES AND DISINCENTIVES

It needs to be reiterated that the proposed regulatory model acknowledges that on the internet there will be two types of products:- those offered by providers that are licensed by a jurisdiction that participates in the model and those offered by entities located outside of participating jurisdictions (prohibitions will stop unlicensed providers from offering products from within participating jurisdictions).

Whilst not attempting to put up walls around the participating jurisdictions there will be disincentives for the "foreign" product and advantages for the licensed "local" providers. As mentioned earlier the disincentives will include controls to stop the "local" advertising or marketing of products offered outside of the model and the harder marketing problem of building consumer trust when there is not a regulator to

guarantee the products integrity or at least not a regulator that the consumer feels they have some control over.

The greatest incentive for players to participate with for the provider licensed by a participating jurisdiction is player protection. Players will know that the provider is not a criminal or criminally influenced, the provider will pay out (and not disappear into cyberspace when the big one is finally won), that games are not "shonky" with results determined after the provider knows what the bets have been placed, that the player's chosen bet limits (or self exclusion) will be enforced and privacy of personal information will be respected.

LICENSING AND PRODUCT CONTROLS

Regulating internet gambling providers, based in the jurisdictions participating in the regulatory model, is within the competence of Australian gambling regulators who have experience in regulating distributed product delivery systems and products that are offered in multiple jurisdictions. The proposed regulatory model goes into some detail on the licensing and control aspects and included below are selected extracts from the model. Further detail is available in the model which, as mentioned earlier, has been supplied as part of the background material.

Given that Victoria's (and most other Australian) gambling licensing schemes incorporate many of the features of the New Jersey Casino licensing system, the licensing aspect should be familiar to United States regulators.

Licensing Scheme

The objective of the licensing scheme is to protect the public interest through ensuring high standards of honesty and operational ability of the gambling service provider and checks on any other party that are in a position to directly or indirectly benefit financially from the conduct of the gambling service.

Those service providers who can not demonstrate a clear ability to pay major prizes from existing financial reserves will be required to lodge a guarantee from a third party with that capability (eg financial institution or parent company). In addition a heavy penalty will apply for unreasonably withholding winnings or money held in a player's account.

The licensing scheme will include:

1. Licensing of service providers only upon satisfactory assessment of the proposed licensee in terms of probity, financial history, capacity to pay major prizes, repute and operational ability.
2. Individual licensing of:
 - directors, chief operating officers of the service provider, persons or companies that hold significant share holdings of five percent or more of voting stock of the service provider and persons with the ability to influence the service provider's decision making process
 - persons that are integral to the proper operation of the gambling product offered, or
 - persons or companies that are able to influence the outcome of the gambling products offered, or
 - persons involved in the recording of the results of players participation, or
 - persons involved in reporting of the financial aspects of the product to the regulatory body
 - all employees and contractors of the service provider unless the licensing jurisdiction is satisfied that the person or company is not one of the above.

The licensing process of individuals will include finger printing, financial and criminal history assessment, evaluation of ability to perform role and a examination of the suitability of associates of the intended licensee.
3. Probity assessment of associates of the service provider and individual licence holders for suitability to be so associated.

4. An ability to inquire into, including requiring licensee to provide updated information, and reassess the suitability of licence holders and associates on an ongoing and as needed basis.
5. A power to give directions to a licensee to cease an association with an unsuitable associate.
6. A discretionary power to review contracts entered into by a service provider to require the service provider to not enter into or discontinue a contract if (a) the other party has not been tested and passed probity or (b) the terms of the contract give reasonable grounds to believe the contract is designed to thwart the purpose of the other provisions of the licensing scheme.
7. An ability for an appointed receiver or liquidator to temporarily continue a service provider's operations until the licence is transferred or cancelled.

Operational Controls

It is proposed that control over operational aspects of each product be primarily technology based using similar principles as used by regulators in establishing controls for distributed gaming machine networks. These networks are in place in all Australian jurisdictions that have introduced machine gaming in the 1990s and include Queensland, Victoria, South Australia, the Northern Territory and Tasmania.

For each proposed product the service provider will be required to demonstrate that the system provides effective protection of player entitlements and can be easily audited by the regulator to confirm that all parties are receiving their correct distribution from the product

The premises from which the service providers conducts the gambling must be approved.

Only approved games may be offered.

A game will not be approved unless the regulatory body is satisfied that:

- the game is not designed to give the player a false expectation by misrepresenting any event
- the rules of the game are not unfair or misleading
- the rules of the game are available to the player and the game operates and interacts with the player strictly in accordance with the rules
- the game has a statistical return to the player of at least an advertised minimum unless the game rules make the house advantage clear to the player.
- all equipment and software integral to the security of the product is approved and located at the provider's approved premises
- adequate transaction logging occurs to ensure dispute resolution is transparent
- the service providers operational procedures and system of internal controls are adequate.

The critical components of the equipment and software will not be approved by the regulator unless:

- it is tested and found satisfactory by a technically competent laboratory
- the regulator has the capacity to check that only approved hardware and software are in use.

Each regulatory body will act as a agent for receiving complaints about any product offered under the model and passing the complaint onto the relevant regulator.

A ground for action against a service provider's licence will result if the service provider fails to maintain privacy of player information and abide by a set of privacy principles.

WHAT ADVANTAGES/DISADVANTAGES DOES INTERNET TECHNOLOGY OFFER OVER TRADITIONAL FORMS OF GAMBLING IN TERMS OF ENFORCEMENT?

Because regulated internet gambling will require player registration a whole range of advantages exist so long as the regulator ensures the provider has procedures in place to ensure that only players who have proven their identity, age and place of residence are registered. Specifically, controls on minors gambling,

credit gambling, problem gambling and money laundering are able to be applied comprehensively through player registration unlike other gambling forms where transactions are anonymous and controls have often proven difficult if not impossible to implement.

Providers will be able to effectively preclude minors (in Australia persons less than 18 years) when registering players.

Providers can be prohibited from allowing the accounts to have a negative balance and the legislation can provide a general prohibition on gambling providers allowing credit gambling.

Unlike traditional gambling forms player registration will allow proactive approaches to compulsive and problem gambling. Providers can be required to offer players the ability to set maximum bet levels or maximum total bets for a period. Cooling off periods can be imposed on changing limits.

Persons can be allowed to self exclude themselves from being registered as a player or from setting up an account with a provider.

Service providers can be required on their web pages to make available information on contact points for problem gambling services. Providers can be required to institute identification of players at time bets are accepted such as a personal identification number or password. Accordingly, only in situations where the registered player has divulged this to another party will that other party be able to bet as if the registered player.

Anti-money laundering controls are also enhanced by the player registration process. A lot has been said about the potential for money laundering in the "virtual world" and no doubt this is a major cause for concern for anti money laundering agencies. However, for regulated internet casinos the opportunities for money laundering will be minimal.

In the virtual world where money will be exchanged for anything that can be digitised a regulated internet casino will not be attractive to a criminal attempting to launder money. The true value of many things that can be digitised (such as software or information) is often impossible to quantify and in these circumstances the greatest challenge to or anti money laundering agencies will be to catch those using the intangibility of digitised "things" to legitimise illegal or unexplained income.

Regulated internet casinos in Australia will have stringent account establishment rules and audit trails which will discourage to the criminal element from trying to wash illicit or unexplained income.

WHAT DOES THE AUSTRALIAN REGULATORY REGIME REQUIRE OF INTERNET GAMING OPERATORS IN REGARD TO ACCEPTING BETS FROM PLAYERS RESIDING OUTSIDE OF AUSTRALIA WHERE THE ACTIVITY MAY BE ILLEGAL?

It is not planned to enforce other jurisdictions prohibitions.

What is legal behaviour by patrons resident in participating Australian States will be allowed by overseas patrons.

It is basically poor policy to agree to superintend requirements or standards over which you do not have control how they are set. More importantly once you start where do you stop. Across the world such things as the age of majority and the legality of gambling vary greatly. Except where there are inter jurisdictional agreements in place for tax remittance there is no intention of making global gambling providers work to different rules on the basis of where the player is resident. It is impossible to embrace the internet as the new and global information and commerce superhighway and then try to apply conditions and restrictions desired by thousands of individual different localities.

Accordingly, it is not intended that automatic grounds for action under Australian law (against the provider's Australian licence) would be triggered by the provider not refusing to do business with a person who resides in a locality where gambling is prohibited. However, should an Australian based provider be convicted of breaching any other jurisdiction's laws it would, in the normal course of events, be a matter considered by the Australian regulatory body that licensed the provider when assessing the ongoing suitability of the provider to hold their licence.

CAN PROHIBITION OF THIS ACTIVITY IN THE UNITED STATES BE ENFORCED UPON AN AUSTRALIAN COMPANY?

It is a matter for those US States that prohibit gambling as to what action they take against a licensed Australian internet provider that conducts business with residents of those States. I understand that other panellists will examine the likely success of any extraterritorial action launched by one of those States or federally.

HOW IS THE INDUSTRY EXPECTED TO CHANGE AS A RESULT OF BEING REGULATED IN AUSTRALIA?

Provided a regulatory approach is taken the current industry will probably experience very little change and possibly no change at all other than adding a new niche market product range to their existing offerings.

Just because something is technically possible (or technically impressive) does not mean it is attractive on a large scale. For example - in Australia telephone betting on horse racing (provided by State based monopolies) has been available for 30 years and is far more convenient than attending the local Totalisator agency (betting shop) to place your bets, what's more it is available across State borders with most operators offering out of State players local telephone call rates. Even so, most totalisator operators still receive less than 10% from telephone operations and the leakage across State borders is minimal.

Similarly whilst internet gambling is technically possible and even convenient it not expected to be a significant threat to location based gambling operations. Research in Victoria has shown that the entertainment and social aspects of a visit to a casino or gaming machine venue are a significant factor in the player's decision to attend a gambling venue and spend some of their disposable income on gambling. No matter how clever the technology, particularly in the short and medium term, internet gambling is unlikely to replace or replicate these important factors in the foreseeable future.

Also, most forms of internet gambling on offer today simply recreate current products in a "virtual" form. As such they will probably never get above niche market penetration. The "killer" application for internet gambling will have to appeal to the demographics of the internet and has not yet been thought up. When it is, it is unlikely to divert expenditure away from location based operations.

In conclusion I thank the Commission for the opportunity to provide input and hope that I have managed to confine myself to matters of interest to Commissioners.

Brian Farrell.