Executive Summary

The Iowa Legislature studied a gambling bill during the 2011 legislative session that considered the legalization of intrastate internet poker for the State of Iowa. The bill was modified during the session taking the form of Senate File 526 and, subsequently, passed the Senate and House before being signed by the Governor on May 26, 2011. Senate File 526 directed a report be prepared by the Iowa Racing and Gaming Commission (IRGC) regarding the creation of a framework for the state regulation of intrastate internet poker.

The United States Department of Justice (USDOJ) believes that interstate internet gambling is illegal based on various federal acts including: the Wire Act of 1961, the Unlawful Internet Gambling and Enforcement Act, the Travel Act, and the Illegal Gambling Business Act. Interstate internet wagering on horse races is legal in many areas of the United States (U.S.) due to the 2000 amendment of the Interstate Horseracing Act. It is the opinion of many industry experts that federal law does not prohibit internet wagering within the borders of a state (intrastate), therefore a number of states, including New Jersey and California, have considered legalizing some form of intrastate internet wagering. Some technical questions have been raised about information traveling over the internet with respect to being in a closed loop; therefore, the activity may not be exclusively conducted intrastate. The USDOJ has not responded to inquiries regarding those questions. As a result, some state lotteries have proceeded with intrastate internet lottery sales. While Nevada was the first state to legalize intrastate internet gambling, in April of 2011, the District of Columbia became the first jurisdiction in the U.S. to begin

to implement intrastate internet gambling games, although operations have yet to begin in the jurisdiction.

The focus of the report prepared by IRGC staff is to address the specific considerations required by Senate File 526 while factoring in the public welfare of the citizens of Iowa. The objective is to evaluate intrastate internet poker and determine the strengths and weaknesses of the many facets of internet gambling regulation in order to ascertain the prospect for effective regulation. The report specifically addresses the current state of unregulated internet poker in Iowa, the available measures and regulations possible to protect participating consumers, and the potential responsible gaming measures that can be employed. The target audience of the report is the Iowa General Assembly. As stated in Senate File 526, this report will not make specific recommendations regarding the legalization of intrastate internet poker in Iowa.

There is considerable and comprehensive literature available on the topic of regulating internet poker that IRGC staff used to conduct a thorough analysis regarding the creation of a framework for the state regulation of intrastate internet poker. The current state of unregulated internet poker play was reviewed: specifically researching the history of internet poker; “Black Friday” events leading to the shut down of three internet poker websites; and studies and projections estimating the internet gambling market. A number of consumer protection areas were reviewed including: licensing of key individuals and companies; prevention of fraudulent behavior; cheating, identity, location and age verification; and security and randomness tests of the gaming network. Existing federal internet gambling regulations were reviewed including those from: the United Kingdom, Canada, Antigua and Barbuda, Alderney, and Isle of Man. Proposed intrastate

internet gambling regulations were also reviewed including those from: Nevada, California, New Jersey, Florida, and the District of Columbia; as well as federal legislation introduced for the U.S. Congress to consider. Current Iowa codified responsible gaming measures were reviewed to determine the possible effectiveness in an internet environment along with existing internet responsible gaming measures employed in jurisdictions where internet gambling is legal.

A considerable amount of research for the report was collected from interviews with knowledgeable parties. Interviews and discussions were held with representatives from the following licensees regulated under Iowa Code chapter 99F: poker room and compliance managers from all licensees, Kehl management, Isle of Capri representatives, Ameristar representatives, Caesars Entertainment representatives, Peninsula representatives, and the Iowa Gaming Association. In an effort to obtain additional information for the report, two potential intrastate internet poker operators were interviewed: U.S. Digital Gaming and SciPlay. IRGC staff met with the independent casino game testing laboratories, Gaming Laboratories International (GLI) and BMM Testlabs (BMM), to receive information about technical standards related to internet gaming. Regulators from Canada and Washington D.C. were contacted and interviewed by IRGC staff in an effort to understand the regulations in place or drafted for internet gambling in those jurisdictions. Information was also received through discussions with the Iowa Lottery, tribes that have entered into a compact with Iowa, and the Omaha Poker Players Association. Third-party vendors such as Aristotle, LOC-AID Technologies, and Quova were also interviewed to learn about technology available to assist with regulation.

A small portion of the data for this research was collected from a survey of brick-and-mortar poker players in relation to any play they may have conducted on the internet. One-third of survey respondents did not play poker online while half of the respondents played a few times a week or more. The respondents identified game integrity as the most important regulatory measure of concern and noted equal levels of dissatisfaction with: loss of internet connection during play, obstacles in depositing and withdrawing funds, existence of poker bots (computer programs that simulate live human play), questions or comments about the legality, randomness of the distribution of cards, and the protection of the identity of the player. This information is the basis for the subsequent research that was conducted in the area of consumer protection.

As demonstrated by the surveys and research of existing studies performed by financial experts, gambling on unregulated internet poker does occur in Iowa. In an effort to determine the amount of unregulated internet poker play occurring in Iowa, three revenue studies were reviewed by IRGC staff. The studies were based on aggregate projections of poker play in the U.S. IRGC staff used assumptions when analyzing the projections and applied them to the population of Iowa. Three methodologies were created by using and applying the assumptions to the studies. The methodologies resulted in a range of approximately $13 million to $60 million in rake by the operators annually. Assuming a tax rate of 22 percent, these projections indicate approximately $3 million to $13 million in potential tax revenue for the state annually. During the 2011 legislative session, a number of sources reported potential tax revenue of $30 million to $35 million to the state annually. One potential company in which the projection originated confirmed the estimate, but was unable to provide the methodology due to

concerns with respect to privacy of the projection. The company did indicate the projection was based on a market after at least three years of operation. Further research is needed in order to obtain tax revenue projection estimates for Iowa. A sound revenue projection may be important and would impact the business model determined by the Iowa Legislature with respect to the liquidity of the market and, indirectly, the regulatory framework. Liquidity, as discussed in this study, is the direct effect the amount of players on a network has on the diversity of the betting limits and game types offered. A network that does not have a high level of liquidity may not meet expectations of internet poker players that are familiar with other internet poker sites. Subsequently, players may not make the transition to a network with less perceived or actual liquidity.

There are two common taxation methods discussed when internet poker is debated. The most widely discussed taxation form is a tax on the Gross Gaming Revenue (GGR), or rake, of the poker site. This methodology uses the same logic as the current Adjusted Gross Revenue (AGR) tax structure on brick-and-mortar casinos in Iowa. The second taxation method would be a tax on each deposit made by each poker player. This tax rate would be significantly smaller than the GGR method as it taxes the money when the poker site receives it rather than on game play. This method has been proposed in situations where countries with broad ranges of liquidity are pooling players. IRGC staff has determined it could adequately audit the taxes paid to the state under either of these methods. Similar to casinos licensed pursuant to 99F, consideration may be given to require the network provider to post a bond to the State of Iowa that guarantees tax payments and that the operation otherwise conforms with the rules and regulations in which the network provider operates.

A key to building a framework for intrastate poker in Iowa is determining which business model fits best. The report evaluates three models, although it recognizes overlapping characteristics and existing differences within each group. A Single Network or Single Hub Model represents a regulatory environment allowing for only one network or provider of online gambling. For the purpose of this report, a hub is a company that facilitates the operation of a network. The Single Network or Single Hub Model is a common structure in Canada. A Single Network Model appears to result in consistent technology and security measures used, allowing for ease of regulation. A Single Network Model would also mean that there would be no competition; therefore, this model may create a conflict with current casino operators should their revenues decrease as a result. In addition, concerns were noted with regard to the perception of independent regulation if the single model is operated and regulated by the State.

A Limited Hub Model would license a limited number of hub operators to provide online gambling. California and New Jersey proposed a similar model in their draft legislation. As with the Single Network Model, a Limited Hub Model would offer limited variations in technology, allowing for ease of regulation. In addition, it is also likely that a Limited Hub Model would increase participation by current casino licensees. The Limited Hub Model does allow for some competition, resulting in smaller liquidity to the networks.

A Multiple License Model represents a regulatory environment that licenses multiple companies to provide online gambling. Alderney, Antigua, and the United Kingdom are jurisdictions with similar models. This model provides for regulatory oversight in a fully competitive environment although it appears the model would be

more challenging to regulate due to multiple networks using various forms of technology. As multiple licenses may cause the number of players to be diluted over all of the networks, liquidity may also be of concern with this model. Consideration should also be given to the potential for new federal regulation and a potential federal model as various federal bills have been previously proposed and are currently being reviewed by federal lawmakers.

All jurisdictions reviewed for this research have fundamental consumer protection standards included in their rules and regulations. The framework for regulation of intrastate internet poker in Iowa should be no different. Age and identity verification is a critical component of consumer protection. Many third-party companies or hub operators use technology that compares personal player information to government websites or public listings to properly identify the player's age. Another possible method of age verification would require individuals to appear in person to register or deposit funds into an internet poker account. Both methods appear to be effective in properly identifying many new internet poker account holders; however, these methods would not completely prevent all underage individuals from participating or attempting to participate in regulated internet poker. For example, if an underage party received internet poker account information (i.e. user name, password, funding source) from an established internet poker account holder voluntarily or involuntarily, it would not be possible to prevent the underage individual from participating in internet poker using either verification method discussed above.

Fraud and cheating detection methods should also be incorporated into any internet poker regulatory framework in order to prevent collusion, money laundering, or

other activity impacting the integrity of the poker game. Third-party companies or hub operators may employ auditing software containing all possible hand outcomes in order to detect various patterns of game play suggesting irregular behavior. This audited and recorded game play can be reviewed by the operator or regulator to determine if fraud or cheating occurs. The player could, subsequently, be banned from playing on the network. Research indicates the software available to detect fraudulent and cheating behavior is very effective; therefore, it should be part of the regulatory framework of internet poker. However, it is not possible to prevent all occurrences of cheating and fraudulent behavior because the detection methods rely on game history. For instances of cheating to be detectable, historical information and data would need to be established regarding any specific activity or method of cheating for any individual involved to be identified by the software.

Methods to ensure the availability of player funds and security of accounts should also be part of any regulations that are developed. Current Iowa gaming law require brick-and-mortar casinos to submit an external audit of their gambling operations to the IRGC annually. These or other types of regulations that address player access to their accounts should be incorporated. External threats to the security of the internet gambling website with respect to player accounts should also be considered. Third-party information technology companies could be utilized to perform periodic penetration tests and to report on or provide recommendations to the internet gambling website in the area of account security.

The approval and testing of the game software and testing of the network and player account security should also be incorporated into regulations. Iowa utilizes the

services of two independent testing laboratories to conduct testing of casino gaming technology. One of those companies, GLI, has developed and published technical standards for the testing of internet gaming networks. GLI-19, the new standard for testing and technical regulations in iGaming, was developed through in-depth consultation with software developers, experienced regulators, and research through current legal and established internet jurisdictions. GLI's internet testing division has a great deal of experience testing networks in Canada and other jurisdictions where internet gaming is legal. Any internet poker provider for Iowa should be subjected to continuous testing of game randomness, network security, disaster recovery, and player account security by an independent company with experience in testing internet gaming systems.

A licensing process incorporating a complete and thorough suitability assessment as a means to prevent criminal or undesirable entities and individuals from participating in the operation, manufacture, or distribution of technology related to the internet poker network should be implemented. Suitability assessments are currently employed for companies and key individuals of entities operating or owning casinos in Iowa and companies supplying gambling games or implements of gambling to casinos in Iowa. This licensing process appears to have successfully prevented participation by individuals unsuitable and not in the best interest of racing and gaming in Iowa. Suitability assessments for parties participating in internet poker in Iowa could be implemented using a similar structure. The costs associated with background investigations are often high, depending on the structure and number of key individuals of a company. Although the entity subjected to the background investigation would likely pay the costs, the

amount involved may limit the pool of potential companies and providers to those who can afford to pay.

A method to identify the location of a person, called geo-location, should also be incorporated into any regulatory framework. Geo-location would provide the technology needed to ensure only players within the boundaries of Iowa are participating. Geo-location software identifies a user's geographical location using the Internet Protocol (IP) address associated with the connected device. Many companies provide geo-location software and claim to offer a high level of accuracy identifying the location of the user. However, research conducted by IRGC revealed geo-location technology using IP addresses can be "spoofed", in addition to its inability to precisely determine the location of a computer. This may cause situations where players located just within the borders of Iowa may not be able to participate in internet poker or allow players just outside of the borders of Iowa to participate, depending on how the geo-location tools are configured. In internet gambling jurisdictions where location is necessary for compliance with regulations, the jurisdictions have typically employed other controls combined with geo-location technology to accurately determine the location of the user. Specifically, some jurisdictions have implemented physical residency requirements, financial account residency requirements, and/or require payments to only be made to registered mailing addresses. Further research on the topic of geo-location and residency may be needed to determine the acceptable ranges and levels of accuracy allowed or desired when developing the regulatory framework for this area.

Various responsible gaming measures can be incorporated into an internet poker environment and most jurisdictions where internet gambling is legal have done so. The

most common measures require the operator to provide educational material to their customer, allow for the ability to set-up self-imposed limits of time spent playing and/or number of games played or amount of money spent, and provide for a process to exclude oneself from participating at all. The self-imposed limits typically require a "cooling-off" period a player must wait before changing the limits set. Iowa law currently requires the brick-and-mortar casinos to participate in a statewide voluntary self-exclusion program. In addition, Iowa casinos have adopted uniform standards to address problem gambling at their facilities. These measures have been tested over time in Iowa and could be incorporated into internet gambling regulations as well.