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Print: Printed in the UK by Pensord Press, www.pensord.co.uk
Published by iGaming Business Ltd, St. Mark’s House, Shepherdess Walk, London N1 7LR, UK T: +44 (0)20 7934 3515 F: +44 (0)20 7934 3511 www.igamingbusiness.com. European Gaming Lawyer is published bi-annually by International Masters of Gaming Law 2013. All rights reserved. No part of this publication may be reproduced or transmitted in any form or by any means, or stored in any retrieval system of any nature without prior written permission, except for permitted fair dealing under the Copyright Designs and Patents Act 1988. Application for permission for use of copyright material including permission to reproduce extracts in other published works shall be made to the publishers. Full acknowledgement of author, publisher and source must be given.

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Cover feature

Binary Options
R Paul Davis offers a regulatory analysis
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As my second and final year as President of the International Masters of Gaming Law winds down, I am very encouraged by the progress that I see in the relationship between gaming regulators and the industry that they regulate.

The invitation by the International Association of Gaming Regulators to the IMGL to co-locate their conferences in Oslo was enthusiastically received by the members of our organization. The co-location of these preeminent organizations’ conferences presents our respective members with an unprecedented opportunity not only to meet and discuss in both professional and social settings significant issues facing the ever changing global gaming industry, but to seek actual agreement relative to long-discussed regulatory reforms. As such, the 2013 IAGR Conference and the 2013 IMGL Autumn Conference in Oslo are a reflection of the mutual interest of regulators and the regulated in not only improving their communication, but also identifying and implementing investigation, enforcement, and compliance practices that are reasonably and rationally designed to ensure the integrity of the gaming industry.

Several of the sessions at the IMGL Autumn Conference will specifically focus on regulatory reform. A forum on Cross-Border Regulatory Reform relative to online gaming will analyze regulatory models that should be considered in this fast growing area of the gaming industry that demands a harmonious regulatory regime designed to ensure cross-border reciprocity of laws and standards. A panel on Internet Gaming in Developing Markets will address regulatory approaches in established online gaming jurisdictions to nascent ones in, for example, the United States, and a panel on the EU Action Plan will address the challenges in the EU in effectively and reasonably regulating online gaming. These speakers from around the world are uniquely qualified to identify both the challenges for new Internet gaming jurisdictions and lessons learned from established ones. I am equally excited about our panel on Regulatory Reform & Implementation. Moderated by former Illinois gaming regulator and gaming company general counsel Donna More, participants on this panel will include such noted gaming regulators as Susan Hensel, who is the current President of IAGR; the UK’s Jenny Williams, Commissioner & Chief Executive, Gambling Commission; and Andre Wilsenach, Executive Director, Alderney Gambling Control Commission, as well as industry Chief Compliance Officer Frank Donaghy of Penn National Gaming, and former Iowa and Mississippi gaming regulator, Sean McGuinness. This panel will address some of the regulatory reforms discussed during the 2011 IMGL Conference (a link to which appears on the IMGL website) and, more importantly, the prospects for implementation of same.

Panels reflecting the evolution of the gaming industry worldwide will focus on Mobile Gaming, Social Gaming, Binary Options, and trends in the liberalization of gaming laws in Europe and the United States, while others will address developments in more traditional forms of gaming, including Sports Betting and Lotteries. Finally, with U.S. jurisdictions coming online, poker liquidity - whether achieved by state-to-state compacts or sharing of liquidity with established European jurisdictions - will be examined with a view to jurisdictions, such as Canada, that already have cross border compacts in operation.

Based on the foregoing, I cannot think of a better final Autumn Conference during my tenure as IMGL President. I look forward to seeing many of you in Oslo.

President’s Message

J. Kelly Duncan, kduncan@joneswalker.com
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PLAYTECH PROVIDES A FULL RANGE OF PRODUCTS & SERVICES ACROSS ALL PLATFORMS
Welcome to the Autumn 2013 edition of European Gaming Lawyer, one of a stable publications produced by the International Masters of Gaming Law (IMGL). European Gaming Lawyer focuses on European and Global legal and regulatory issues of interest to practitioners, executives and academics within the gaming sector.

This is the first edition to be published for IMGL by iGaming Business and to be distributed together with iGaming Business magazine. IMGL is excited to work with iGaming Business, as we believe that this partnership will help us to further improve the quality, reach and impact of the publication.

It is our aim to bring to readers topical and insightful content from contributors who are at the forefront of gaming law and regulatory matters and hopefully to stimulate debate and discussion on key issues facing the gambling industry. In this edition we have a number of contributions updating readers on important developments in various jurisdictions including the Republic of Ireland, France and the United Kingdom as well as a comprehensive review of the position in Norway. We also have a thought-provoking article on the regulation of binary options, a product showing considerable growth in recent years but in relation to which regulatory inconsistency prevails, and an article focussing on opportunities for capital investment in the remote gambling sector.

We also have our regular contribution from the President of the International Association of Gaming Regulators, an organisation with which IMGL enjoys very close ties, and I would like to thank Susan Hensel for her support in this regard and to congratulate her on her achievements in that post, which she will shortly hand over to her successor.

I am grateful to all of our authors for taking the time to prepare their contributions and I look forward to receiving further proposals for stimulating articles in future editions.

Best wishes

Nick Nocton
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Editor
Introduction
During recent years the landscape of the Norwegian gambling market has changed dramatically due to the vast number of internet based gambling companies targeting the Norwegian market. Although this has been a welcome development for Norwegian gamblers and players, the Norwegian authorities has another point of view, seeing it as an unwelcome, challenge to the state owned gaming monopolies. As a result they have to their furthest extent tried to stop this internet based gambling invasion, through the various provisions of the Norwegian gaming laws, with very varied results, in spite of relative recently implemented financial transfer bans and marketing prohibitions.

Norwegian gaming regulations
The basic premise under Norwegian law is that all forms of gaming are prohibited, except where permission to operate such activities is granted under the authority of a legal statute. According to article 298 and 299 of The Norwegian Penalty Code, it is a punishable offence to operate activities in the form of a “game of chance” not sanctioned by special legislation. “Games of chance” includes all types of betting and other types of gaming in which the element of winning is the key. Hence, poker is reckoned to be a “game of chance” by the authorities, however this has recently been challenged by a verdict in the High Court stating that “Texas Hold'em” is to be considered as a game of skill.

Despite the abovementioned general prohibition, there have long been statutory exceptions. These are currently laid down in three acts, which in detailed terms allow certain operators to be granted permits. These are (i) The 1927 Totalisator Act (horse race betting), (ii) The 1992 Gaming Act and (iii) The 1995 Lottery Act.

These three acts so forth constitute a coherent and exhaustive regulation of all forms of lottery and money gaming legally operated in Norway.

In practice, it is The 1927 Totalisator Act and The 1992 Gaming Act that by far have been the most important, regulating all forms of gaming through exclusive rights arrangements. The system developed under the Totalisator Act in effect gives Norsk Rikstoto Foundation an exclusive right to arrange horse race betting and The Gaming Act establishes the state owned gaming company, Norsk Tipping AS, granting to it exclusive rights to other sports based betting and certain number games (Lotto).

In practice this means that all traditionally large gaming activities are subject to the exclusive rights system operated by either Norsk Tipping AS or the Norsk Rikstoto Foundation.

The Lottery Act of 1995 is in principle the general act, comprising all other forms of lottery and gaming. This follows from the wide definition of “lotteries” given in Article 1(a) of the Act as all “activity in which a participant may for a stake acquire a prize as a result of a draw, guesswork or other procedures which wholly or in part produces a random outcome”. The definition of lottery is evidently wide and embraces almost all games that are traditionally offered at traditional casinos. Also games such as bingo, horserace betting, sports betting etc. are considered to be lotteries and therefore under the regulation of the Norwegian Gaming Acts. Only smaller and less important forms of gaming and lottery may be granted a license under the Lottery Act, and only when the profit is donated to humanitarian and socially beneficial non-profit organizations.

It is prohibited and punishable to operate gambling services in Norway contrary to the abovementioned gambling regime. A secondary law (Forskrift om forbud mot spillbetalingsformidling, 2010) prohibits banks to transfer money to foreign gaming companies. However, it’s important to emphasize that it is not illegal to gamble in Norway. Nor is the government practicing any IP blocking towards foreign gaming providers. It is therefore fair to say that there are rich possibilities for foreign gaming providers to offer their services to Norwegian customers.
Marketing Prohibition
Not only the operating, but also the marketing of unlicensed gaming is prohibited according to the Norwegian Gaming Acts.

As a result, marketing of games and lotteries on the Internet is prohibited, with the exceptions of the games offered by Norsk Tipping AS and Norsk Rikstoto Foundation. In principle, the prohibition covers all forms of marketing that is targeted against Norwegian consumers and encourages gaming.

However, the general marketing prohibition for unlicensed gaming operators does not appear to hinder international gaming providers from marketing their products through marketing channels based outside of Norway, e.g. based on the EU broadcasting directive 89/552/EEV which applies for Norway.

As a result, international gaming companies often use TV-channels, websites and servers based outside Norway to market and to offer their services. This marketing, although frowned upon by the Norwegian gaming authorities, is not illegal as long as the marketing is not directly targeted against the Norwegian players. Conclusive in this matter is whether or not the games offered are primarily designated for the Norwegian market.

Financial Transaction blocking
As a result of the expanding gambling possibilities offered to the Norwegian players, the Norwegian authorities passed a secondary law in 2010, prohibiting banks from transferring funds to unlicensed gambling operators.

The financial transaction block is all embracing, and includes all forms of payment methods offered in Norway. As a result, all transfers of funds from Norway to a user location with the Merchant Category Code (MCC) 7995 (gambling activities) will be blocked by the service provider.

Transaction blocking is therefore not dependent on whether or not the institution is based in Norway or operates from the European Economic Area, but how the transfer is categorized under the MCC-system. If the transfer is marked as a 7995 transfer it will automatically be blocked as a result of the prohibition.

Having said that, credit transfers serviced through online banking transfers or bank giro, will not be automatically blocked as a result of the prohibition, unless The Gaming Authority passes a decision concerning blocking of certain account numbers. In June 2010 and January 2011, such decisions were passed by The Gaming Authority and 15 specific account numbers were blocked for standard credit transfers.

In principal the prohibition therefore blocks all forms of transfers to unlicensed gaming operators.

However, nearly all of the gaming companies have now turned towards third-party solutions. As a result of this, and that nearly none of the gaming companies still have their Norwegian bank accounts, it has become hugely complicated for The Gaming Authority to pass new decisions blocking financial transactions.
transfers to certain account numbers. As a result, the transfer of funds through standard credit transfers is once again open. The Norwegian Gaming Board recently published its evaluation report of the transfer ban. The Gaming Board concludes that the transfer ban has not had the desired effect, and that transfers to international gaming companies unlicensed in Norway still continues undisturbed, in spite of the prohibition. The Gaming Board is not satisfied with the development, but lacks the authority and tools to counteract the development. The prohibition is therefore highly ineffective and the Gaming Authority has few or no measures against these transactions as the prohibition is only applicable for transactions marked as gambling related, and as the third-party solutions remove this connection, the prohibition is nearly impossible to enforce.

Violations of the Norwegian gaming provisions
In the event that a gambling operator is in breach of the provisions laid down in the Norwegian gaming acts, this could in principle lead to criminal sanctions. But so far, the Norwegian Gaming Authority has only issued administrative sanctions to companies in breach of the Norwegian regulations. However, if the gambling operator is very aggressive towards the Norwegian market and does not comply with relevant administrative sanctions issued by the Gaming Authority, the possibility of criminal proceedings cannot be excluded. The prosecution of a foreign based gaming company would, however, raise jurisdictional issues pursuant to The Norwegian Penal Code. As of today, it is unclear whether or not Norway will have jurisdiction with regards to a penal prosecution of such companies.

This is supported by the statements made in the Norwegian white paper (Ot-prp. nr. 44 (2002-2003)) where jurisdictional issues pursuant to The Norwegian Penal Code are discussed in context with Norwegian gaming companies offering unlicensed gambling from branch companies based outside of Norway. The committee stated that the prosecution of a gaming provider offering unlicensed gambling from another country to Norway would be difficult, unless the offered game is illegal in the country from which it was provided.

However, The Norwegian Gaming Board stated in a case against eurolotto.com in April 2011, that Article 12 of The Norwegian Penal Code would be applicable as the effect of illegal targeting and marketing towards the Norwegian market will fulfill the conditions laid down in Article 12 of The Norwegian Penal Code.

Under the current situation criminal proceedings as a result of infringements to Norwegian gaming laws therefore constitutes a challenge for the Norwegian Authorities, and our impression is that it is therefore unlikely that the Norwegian Authorities would pursue such a case exhaustively.

EU/EEA Compatibility
Norway is obliged, as a European Free Trade Association (EFTA) Member State and party to the European Economic Area (EEA) Agreement, to comply with the provisions of the EEA Agreement.

Several gaming organizations and gaming companies are critical of the Norwegian gambling system, and are of the opinion that the gaming system is in defiance with the EEA Agreement. Some gaming companies have challenged the Norwegian gaming regulation under the references to the EEA Agreement. Particularly relevant in this matter is Article 36 of the EEA Agreement regulating the freedom to provide services.

Relevant in this matter is Case E-3/06, “Ladbrokes”, relating to the Norwegian sports betting regime. Ladbrokes claimed that they were legally entitled to provide their services to and within Norway as a consequence of their valid gambling license issued in another EU/EEA State.

As a result of Ladbrokes claim, Oslo City Court asked the EFTA Court for their evaluation on the matter. The EFTA Court concluded that each EEA Member State has the right to require possession of a license, thereby rejecting the automatic recognition of a license issued by another EU/EEA Member State. The City Court therefore rejected Ladbrokes claim.

The Norwegian system has on these grounds, so far, proved itself to be in compliance with the relevant provisions of the EEA Agreement and the relevant EU/EEA case law.

Closing remarks and thoughts on a changing regulatory landscape in Norway.
The Norwegian gaming regulations may at first seem rigorous and make the Norwegian gaming market seemingly unavailable for international gaming providers. But like most international based operators you will probably experience that a wide range of gambling service can be offered to the Norwegian players without any interference of the Norwegian Gaming Authorities if these services are rendered from outside Norway and not marketed aggressively and explicit for the Norwegian market and player.

If relatively basic ground rules are followed the operators should steer clear of the Norwegian gambling prohibitions and may even find that the Norwegian internet based gambling market is more open than at first glance. This will especially apply for the games qualified as “social gaming” as these games will not fall under the gambling definition according to the Norwegian regulations, and can thus be offered freely to and within Norway.

With regards to changes in the Norwegian gaming regulations, it would not be an honest assessment if we were to claim that a more open legislation is on the horizon. However, gambling regulations are changing rapidly across Europe, and the Norwegian Gaming Authorities are watching these developments closely, especially with regards to the newly implemented changes in Denmark.

The new Danish gambling regime together with potential changes in the Swedish system and the developments in European countries may even eventually push through a change in Norway as well.

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From gaming to gambling – Skill, social and mobile gaming on the regulators’ radar

With its wide success and increased monetization, the gaming industry has necessarily attracted the attention of regulatory institutions throughout Europe who critically observe the shift from casual gaming designed to bring people together towards commercial services essentially aiming at generating profit.

This raises the question of where to draw the line between casual gaming and speculative gambling.

The French legislator seems to consider that both industries should fall under one and the same prohibition principle, already contained in the Lotteries Act (see below). Discussions on the reform of French consumer law plan to extend the prohibition of lotteries to games of skill interpreted in the broadest sense, so as to also include social and mobile games.

Thus, France may well be paving the way for other European regulators to take action as regards the social gaming industry. Yet, the French government’s approach cannot efficiently meet the motives of public interest invoked to justify legislative interference.

Current legal framework

Understanding the impact of the proposed amendments requires a prior overview of the current situation.

To date, the French legal framework in relation to gambling is constituted by several pieces of legislation, the exact scope of which is not precisely defined and mainly relies upon case law:

- The 1836 Lotteries Act concerning the prohibition of lotteries, recently included under Article 322 of the Homeland Security Act, which bans “any operation offered to the public, under any designation whatsoever, which creates the expectation of winning a prize by means of chance”;
- The 1983 Act concerning the prohibition of games of chance included under Article 324 of the Homeland Security Act which mainly prohibits holding a gambling establishment open to the public, exploiting unauthorized games of chance with a monetary stake, importing, manufacturing or exploiting any machine working on a chance basis and procuring any direct or indirect advantage upon commitment of a stake;
- The 2010 Online Gambling Act which defines a game of chance as “a paying game where chance predominates over skill and on the combinations of intelligence to obtain the prize”;
- Article L. 121-36 of the Consumer Code concerning commercial lotteries which considers that “advertising operations in writing which tend to raise the expectation of a prize attributed to each participant, whichever the modalities of drawing, can be made only if they do not impose any financial contribution or expense of any form. When the participation in the operation is subject to a prior purchase, the operation is only illegal if it is unfair”.

On these grounds, French case law and scholarship authors traditionally consider that a given game qualifies as a game of chance or lottery subject to licensing or prohibition provided that four specific cumulative elements are fulfilled: (i) an offer to the public, (ii) requiring a financial sacrifice, (iii) which creates the expectation of a gain, (iv) by means of chance.

If one of the elements is missing, the game is legal per se. However, if a game fulfils all 4 conditions and is not operated by a duly licensed company, it would be considered illegal in France should the operator accept wagers from the French public.

Proposed amendments within the Assemblée Nationale

The proposed amendments to French gaming law as contained in the Bill on Consumption1 appear not to recognise the typical, industry-based differences made between gaming and gambling as they plan to include both under one and the same general prohibition principle laid down in the Lotteries Act. Furthermore, no distinction is being made within the various areas of gaming, whether as to the device being used (computer, mobile, social media) or the type of transaction proposed (e.g. pay-to-play or freemium).

This leads to a gap between legislation and the market due to a lack of understanding by the French legislator of the variety of gaming activities at stake and the fact that the specific features of each should be taken into account within an adapted regime.

Basically, in the eyes of the French regulator of online games of chance (ARJEL), it just comes down to protecting consumers against “supposedly free of charge online games, games supposedly based upon skill or games where the gains are supposedly virtual” as expressed in its wishes for 20132.

This call for legislative intervention was echoed...
by the Government under the form of amendment 960 to the Bill on Consumption introduced on 20 June 2013 before the Assemblée Nationale by the Rapporteur of the Commission of Economic Affairs, Mr. Razzy Hammadi.

The amendment seeks to extend the principle of prohibition of lotteries contained in Article 322 of the French Homeland Security Act to: “All operations available to the public, under any name whatsoever, that give rise to the hope of winnings that would be, even partially, due to chance and for which a financial sacrifice is required from the participants by the operator.

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It further adds that “This prohibition includes games whose operation is based on the player's know-how (read “skill”).

The financial sacrifice is considered fulfilled when the organizer requires an advance payment from the participants, even if a subsequent refund is made possible by the rules of the game.

An exception is nevertheless foreseen under the supervision of the French Audiovisual authority, for TV games and competitions utilising premium-charge calls or sms ancillary and in direct relation to a broadcast television or radio programs, as long as a refund of communication and correspondence costs is provided upon the participant’s request.

The declared purpose of amendment 960 is twofold: first, to clarify the prohibition of so-called skill games and, secondly, to ban so-called “free” games in which players can be refunded their stakes according to a refund clause, otherwise than under the limited TV and radio exemption.

Amendment 960 also intends to harmonize French gaming legislation by aligning the definition of online games of chance provided by the 2010 Online Gambling Act with that contained in the French Homeland Security Act.

Unfortunately, it does so in a most restrictive manner. While the Online Gambling Act refers to predominance of chance over skill to fulfill the condition of chance, the new version of the Lotteries Act introduced by amendment 960 – to serve as a general reference – considers chance to be fulfilled in any case if the game is only very partially relying upon chance or even when the outcome of the game solely depends on the player’s abilities.

This excessively broad wording would lead to the prohibition of any type of publicly available game or competition which requires a financial sacrifice and may offer a chance to win an advantage. Considering, on the basis of French case law and the 1983 Act, that internet connection costs are deemed a financial sacrifice and that extra playing time can be interpreted as a prize, the four cumulative conditions for a game to qualify as a game of chance are met by almost any game, competition or even sports challenge.

The Bill seems completely oblivious to best practices developed by the social and mobile gaming industries such as the limitation of pay-ins through micro-payment transactions or the absence of pay-out possibilities and thereby, somewhat inadvertently, places...
all video, skill, social and mobile games or competitions on shaky legal grounds, along with illegal gambling operations.

**Motivation**

The motives invoked to justify state intervention rely on the protection of public interest and public health as the government puts forth issues similar to those raised by gambling activities: risk of addiction, money laundering, fraud, manipulation of results due to the use of bots.

Regrettably, these motives do not rely on any facts, studies or numbers showing any kind of correlation between skill, social or mobile gaming and these risk factors.

In the eyes of French authorities, a legal clarification is all the more needed as, in its decision of 17 January 2013, the Court of Appeal of Toulouse held that, for experienced players, poker could be considered a skill game. Consequently, the defendants were discharged from organizing illegal poker games which involved more than a hundred players. This characterization would suggest that it is possible to legally organize poker games without having been previously authorized which is why an amendment clearly extending the scope of the prohibition to skill games has been introduced.

**Legislative developments and agenda**

Amendment 960 was adopted in first reading during the night of 27 to 28 June 2013 without causing much of a stir, becoming during the first weeks of September. If the two chambers of Parliament agree on the same draft, the Bill could already be adopted and translated into legislation.

**Critical assessment**

Article 72 quarter of the Bill on Consumption offers a welcomed harmonization of a legal framework on gambling so far constituted by scattered pieces of legislation and case law. Unfortunately, it does so at the expense of the stakeholders and legal certainty.

Instead of enshrining once and for all that a game of chance is “a paying game where chance predominates over skill and on the combinations of intelligence to obtain the prize” as already defined by the Online Gambling Act since 2010, the legislator stretches the notion of chance beyond reason in favour of a general prohibition which is neither compatible with the legitimate demand for entertainment arising from information technologies consumers, nor with the policy pursued on the other hand for regulated gambling.

As pointed out correctly by Member of Parliament (and of the opposition) Jean-François Lamour in his speech before the Assemblée Nationale, a pure and simple prohibition runs the risk to backfire and fuel the black market instead; because the demand is not only undeniable, it is also very much legitimate in a modern economy. More alarmingly, in the absence of a legal gaming offer, a pure and simple prohibition also runs the risk to trigger player migration from gaming to gambling, which raises much more concerns in terms of pathological gambling and fraud.

In the context of a gambling market open to competition since 2010, a strict prohibition of gaming operations, whether skill, social or mobile, for reasons of public health and public safety hardly seems proportionate. On the contrary, should the current version of the Bill pass the vote, its provisions would breach the general principles of freedom of commerce as well as the fundamental European law principle of freedom of services provision contained in the Treaty on the Functioning of the European Union. The suggested changes are simply not in line with a necessary, proportionate, non-discriminatory, coherent and systematic policy to fight against fraud and addiction, as repeatedly required by European case law if, on the other hand, gambling is open to licensing.

Player protection and the fight against fraud and money-laundering are considerations called for by the gambling industry and social media themselves since long-term growth in times of economic models based on user-generated content can only be achieved in a trustworthy market and through a trustworthy platform.

Reasonable regulation is an essential component of a user’s trust towards the online economy. A regulatory regime mindful of the actual issue at stake, namely the risks brought by excessive speculation – naturally related to the level of chance – would be a positive improvement and actually allow operators to contribute to the system by generating tax revenues. With regulatory requirements upon the gambling industry milder than those applied to gambling (for instance by introducing a notification procedure rather than license applications as such), the condition of proportionality could be safeguarded in line with sound EU law principles.

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8. CJEU, 24 March 1994, Case C-275/92, Schindler ; CJEU 21 Sept. 1999, Case C-124/97, Lairot ; CJUE, 21 Oct. 1999, Case C-67/98, Zeturf ; CJUE, 6 Nov. 2003, Case C-243/01, Gambelli ; CJUE, 9 Sept. 2003, Case C-42/02, Lindman ; CJEU, 6 March 2007, Case C-539/04, Placanica ; CJUE, 8 Sept. 2009, Case C-42/07, Santa Carla ; CJUE, 8 July 2010, Case C-647/08 et C-448/08, Otto Sjöberg, Anders Gerdin ; CJUE, 8 Sept. 2010, Case C-40/08, Carmen Media Group Ltd and Case C-258/08, Ladbrokes ; CJUE, 8 July 2010, Case C-408/08, Otto Sjöberg, Anders Gerdin ; CJUE, 8 Sept. 2010, Case C-40/08, Carmen Media Group Ltd and Case C-316/07, Markus Stotz ; Case 408/08 Winner Wetten GmbH ; CJUE, 8 Sept. 2010, Case C-648/08, Engelmann ; CJUE, 30 June 2011, Case C-212/08, Zeturf.
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The move to licensing and taxation of remote gambling on a point of consumption basis in the UK gathers pace. The Gambling (Licensing and Advertising) Bill (the "Bill"), which will amend the licensing requirements of the Gambling Act 2005, received its first reading in the House of Commons on 9th May 2013 and is expected to become law by the end of 2013 and take effect from as early as April 2014.

Meanwhile, on 16 August, HM Treasury published its legislative proposals on taxation, in light of the responses received from the industry to its tax consultation.

The Gambling (licensing and Advertising) Bill

What is the effect of the Bill?

i) The Bill will extend the territorial application of Section 33 of Gambling Act 2005 (the offence of providing facilities for gambling), requiring all remote operators to obtain an Operating Licence from the Gambling Commission if they wish to do business with British residents. The Bill will do this by substituting Section 36(3) as follows:

Section 33 applies to the provision of facilities for remote gambling only if –
(a) at least one piece of remote gambling equipment used in the provision of the facilities is situated in Great Britain, or
(b) no such equipment is situated in Great Britain but the facilities are capable of being used there.

ii) The Bill also proposes the repeal of the offence of advertising foreign gambling (Section 331) and would thereby remove the current exemption permitting operators licensed in EEA and "white-listed" jurisdictions to advertise their services in Britain without a British licence.

iii) It would also extend the territorial scope of the offence of advertising unlawful gambling (Section 330) and the regulations controlling the advertising of remote gambling by way of remote communication (Section 328) by amending Section 339(9) in line with the amendment made to section 36(3).

The Case for Change

Much has been written before concerning the basis for the imposition of point of consumption licensing, and many have speculated as to the possible susceptibility of the measures to a challenge on the basis that their compatibility with European law. For its part, the government concludes that, “the current system is flawed and can no longer adequately ensure the protections for British customers the [Gambling] Act envisages in a changing European and International landscape”.

It cites the following as justification for the proposed changes:

• Although the majority of operators targeting British customers are subject to established and effective regulatory regimes, not all are. The Gambling Commission are aware of emerging European jurisdictions where very little is known about the level of regulation and consumer protection.

• There are different regulatory approaches overseas with limited consensus in areas such as standards and software testing resulting in varying levels of protection for British customers.

• There is a potential risk that match fixing and suspicious betting practices are taking place on overseas licensed sites.

• It is becoming increasingly difficult to identify the level of regulatory oversight of gambling services and equipment when operators are permitted to locate equipment in different locations. This can lead to confusion for consumers and prevents the Gambling Commission from being able to directly investigate complaints.

The Gambling Commission has been pressing the UK government to make the changes for some time citing the difficulty it has in fulfilling its statutory obligations to advise the government on gambling, its regulation...
and impact, in circumstances where it regulates less than 15% of the online British market. The Chief Executive of the Gambling Commission, Jenny Williams, has suggested that to achieve consistent regulation and to ensure the government is properly informed on regulation, it is necessary to repatriate regulation of the domestic British market.

**Implementation**

On the basis of the Bill passing into law in December 2013, it is expected that implementation would be in April 2014 and the Commission anticipates that it will start inviting applications for licences in February. Under transitional arrangements operators already licensed in EEA and white-listed jurisdictions will be able to apply for interim licences, which will enable them to continue operating pending the grant of a full licence, subject to compliance with the Commission’s Licence Conditions and Codes of Practice.

The Commission will be consulting with stakeholders on ways in which existing codes of practice and licence conditions might be improved, including on the Commission’s approach to the protection of player funds and on international liquidity in poker networks. The Chairman of the Commission Philip Graf has said as follows, “Currently, there is a range of approaches internationally to regulating poker networks. We have been very active in IAGR’s work exploring potential good practice in such regulation - a degree of consensus is needed if jurisdictions are to be comfortable in allowing their players to be pooled with those subject to other jurisdictions’ requirements – or lack of them.” However, he confirmed that the Commission does want to facilitate cross jurisdiction liquidity pooling provided players are properly protected.

**Enforcement**

In the same speech Mr. Graf gave an assurance that, once licensed, operators can expect their right to operate into the UK market to be protected from illegal competition. However, the government does not currently intend to introduce powers to block websites or financial transactions. The Commission has expressed confidence that the commercial advantages of being able to advertise openly, backed by the regulator’s role in deterring illegal advertising would keep the black market relatively small.

Although the Commission has prosecution powers it does not expect to have to use them often as experience had shown that those asked to desist from any involvement in illegal advertising do so once the illegality is pointed out.

**Point of Consumption Taxation**

Meanwhile, the proposed transition to taxation on a point of consumption basis is expected to leave those operators who are licensed outside of the UK, but who are currently permitted to advertise here and accept UK customers without having to pay UK gambling taxes, with a significantly increased costs.

Following the announcement in the 2012 Budget that the taxation of remote
The government reports that the majority of residents whilst temporarily abroad will undertake by a customer who usually lives abroad whilst temporarily in the UK will be confirmed by the Chancellor of the Exchequer in his Spring 2014 Budget, planned for 1st December 2014.

The rate of remote gambling duty payable will be confirmed by the Chancellor of the Exchequer in his Spring 2014 Budget, and operators will continue to lobby hard for rates lower than the 15% rate which currently applies to the relevant duties.

i) Definition of UK Person:
The government originally proposed that operators would be expected to take reasonable steps to determine the location of their customers in order to ensure that the taxes could be levied on those transactions taking place with persons located in the UK. However, the majority of operators who responded to the consultation successfully argued that it would be very difficult to identify the location of each transaction and costly to oversee, and had concerns about a lack of certainty regarding the what steps might be considered “reasonable.” The majority of consultees favoured a system whereby their UK customers are determined by reference to where they usually live and the government now proposes to adopt such a definition. Therefore remote gambling undertaken by a customer who usually lives abroad whilst temporarily in the UK will not be liable for tax, whilst bets made by UK residents whilst temporarily abroad will.

ii) Enforcement measures:
The government reports that the majority of respondents supported the introduction of a strong and robust enforcement regime. It has now provided greater detail of the proposed enforcement measures. In the first instance these will include:

- working with other tax jurisdictions to recover outstanding tax debts, including through the EU Mutual Assistance in the Recovery of Debt scheme;
- requiring operators based in jurisdictions with which the UK does not have collection agreements to either appoint a joint and severally liable fiscal representative or appoint an administrative representative and provide security;
- requiring operators with a poor compliance history to provide security. Failure to comply with requirements to appoint a fiscal representative or a security will be made criminal offences.

In “serious cases of non-compliance” where an operator breaches certain triggers, HMRC will initiate a process that will require the Gambling Commission to suspend its Remote Operating Licence. These will include:

- Failure to register for the payment of duty
- Failure to adhere to key registration requirements
- Where there is a failure to abide by “time to pay” agreements
- Where an assessment for unpaid duty is made and not paid by the due date
- Where there is late payment with default extending to 3 months for 2 accounting periods or one accounting period where the default extends to 6 months, within a 5 year period.

Following suspension of an Operating Licence if tax remains outstanding after 6 months HMRC will require the Gambling Commission to permanently revoke the licence, subject to the right of appeal to the Tax Tribunal. The government intends to prevent the Commission issuing a new licence until any outstanding “tax failures” have been rectified.

In unveiling the latest proposals the Economic Secretary to the Treasury, Sajid Javid said, “It is unacceptable that gambling companies can avoid UK taxes by moving offshore, and the government is taking decisive action to ensure this can no longer happen in the future. These reforms will ensure that remote gambling operators who have UK customers make a fair contribution to public finances.”

In addition to the tax implications of the legislation licensed operators will be required to contribute to British problem gambling research, education and treatment and regulatory costs. The Remote Gambling Association has voiced concerns over the substantial increase in costs that the changes will bring, which it says may drive smaller companies out of business. Certainly, there are real risks that the increased costs will affect investment, adversely affect prices/ odds and restrict competition. Meanwhile, black market operators may seek to avoid UK licensing and tax altogether, undermining the position of those companies who comply.

There is talk of a potential challenge to the compatibility of the proposals with European Union legislation but this could not be mounted until the Act receives Royal Assent.

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Irish Regulatory Reform Gathers Pace

Joe Kelly, John Cahir And Katie Byrne

Introduction

On 15 July 2013, the Irish Minister for Justice published the “General Scheme of the Gambling Control Bill”, a 90-page blueprint of a proposed new regulatory framework for gambling in Ireland.

The publication of the Scheme signals a firm intention on the part of the Irish government to introduce a comprehensive licensing regime for Ireland’s gambling sector, and to modernise the existing outdated legislation.

Gambling is currently regulated in Ireland by a 1931 Betting Act and a 1956 Gaming and Lotteries Act, neither of which is equipped for the modern communications environment. The result is that several aspects of Irish gambling law are “grey”, particularly in relation to remote gambling, which is not specifically addressed by either piece of legislation.

While the gaps in the 1931 and 1956 Act, and a dearth of enforcement on the part of the Irish authorities, have allowed land-based and online operators to establish gambling businesses in Ireland without being licensed to do so, the absence of legal certainty is unsatisfactory, and it has deterred many operators from considering locating in Ireland or the targeting the Irish market.

Legislative reform has been on the agenda for some time now. In 2006, the “Casino Regulation Committee” put forward 32 recommendations for the regulation of gambling in Ireland. That report was not acted on for a few years, but following a public consultation which concluded in September 2009, the Department of Justice set up a “Casino Gaming Control Unit” to grasp the nettle of gambling law reform. This Unit produced an “options” paper, setting out specific proposals in relation to the regulation of gambling in Ireland, which was published in December 2010.

This article synopsises the key features of the Scheme of the Gambling Control Bill. It is however important to bear in mind that the Scheme is a draft document, which is likely to evolve substantially as the legislative process unfolds.

Scope of new gambling regulatory regime

In general terms, most forms of gambling will, subject to restrictions, be permitted under the proposed legislation (including casino gaming, betting, lotteries, bingo, gaming and amusement arcades), but all gambling operators (both land-based and remote) supplying gambling services to Irish customers will be required to obtain a licence. The specific category/type and number of licences will depend on the nature and size of the gambling operation.

In total, the Scheme proposes the creation of 43 new licences, covering both land-based and remote gambling activities, which broadly fall into 6 categories: betting licences; gaming licences (this category will include lottery and bingo licences); licences for mixed remote gaming and betting; temporary licences; hybrid/cross-over licences; and personal licences.

The Scheme also proposes the introduction of a “registration scheme” for companies who establish gambling services or gambling support services in Ireland, but who do not target Irish players.

There are some areas of the gambling sector which the Gambling Control Bill will not regulate. The main exclusions from the Scheme are the National Lottery, the activities of Horse Racing Ireland and the Irish Greyhound Board (Bord na gCon), financial spread betting and the State-owned Tote.

A New Gambling Regulator

Under the proposed new regime, applications for licences will be made to a new gambling regulator, provisionally entitled the “Office of Gambling Control ("OGCI"), although the Irish Courts will have a role in relation to appeals and certain enforcement matters. The Scheme sets out in broad detail the procedure which will apply to licence applications, but it is envisaged that more detailed guidelines will be published by the OGCI.

As well as dealing with licence applications, the OGCI will also act, in effect, as an “inspectorate” for all gambling regulated under the legislation.

OGCI officers will have full powers to search, seize documents, etc., and the OGCI will be able to seek Court orders directing service providers, financial institutions, advertising services, etc, not to assist unlicensed or non-compliant remote gambling operators offering their services to Irish customers.

The Scheme proposes the introduction of a statutory basis for cooperation between the OGCI and other bodies, including the Irish police (An Garda Siochana), the Revenue Commissioners,
the Private Security Authority, as well as other regulators outside Ireland. Notably, the Scheme includes a Head entitled “International Co-operation”, which provides for consultation between the OGCI and its regulator counterparts in other jurisdictions, with a view to entering into “memoranda of understanding”, in relation to various matters.

**Key Features**

**Betting**
- The Scheme proposes the creation of 10 basic categories of betting licences, including specific types of licences for land-based bookmakers; land-based bookmakers who also offer some remote services; remote betting licences; on-course betting licences; betting exchange licences; pool betting licences; and spread betting licences.
- Limited gaming may be permitted in betting shops, although this will require a separate licence, and cash transactions will not be allowed.
- The Scheme proposes a complete ban on “fixed odds betting terminals”, although this was widely anticipated, due to the political contentiousness which has traditionally surrounded “FOBTs” in Ireland.

**Land Based Casinos**
- It is proposed to cap the number of licensed casinos at 40 (there are approximately 30 “private members’ clubs” currently registered for the purposes of Irish anti-money laundering legislation).
- Only smaller scale casinos will be permitted – it is proposed to limit the number of gaming tables and gaming machines to 15 and 25 respectively, effectively ruling out the possibility of an Irish “resort” casino. This is notwithstanding the fact that a number of large Irish casino projects have been mooted in recent years.
- The OGCI will be required to ensure a regional spread of casinos, according to published criteria.
- It is proposed that casino licences will be 10 year licences, which may be renewed.
- The proposed permitted hours of operation will be between 11:00 a.m. and 4:30 a.m.
- The Scheme contemplates that the sale of alcohol will be permitted in premises containing casinos. However, it provides that there must be “full and complete separation” between the area used as a casino and the area licensed under the Intoxicating Liquor Acts. Furthermore, the Scheme contemplates that it will not be possible for alcohol to be brought into or consumed in the area reserved for casino gaming.

**Lotteries**
- Under the Scheme, certain smaller lotteries will not require a licence (although they will need to be notified in advance to the OGCI). The Scheme proposes that three types of lottery licence will be available depending on the level of prizes. Under the Scheme prize funds exceeding €50,000 per week or €250,000 per month (but subject to a maximum of €400,000 per month) will be permitted. This is a significant increase from the current prize limit of €20,000 per week under the 1956 Gaming and Lotteries Act (although the recently enacted National Lottery Act, 2013 includes a provision whereby this cap can be increased to €30,000).
- To obtain a lottery licence, three key conditions must be fulfilled: the lottery must be in aid of a “charitable or philanthropic cause”; there must be a link between the charitable and philanthropic cause and the locality where the lottery is to be held; and a minimum of 25% of the proceeds of ticket sales must be allocated to the charitable or philanthropic cause.
- A separate licence will be required for scratch cards. The maximum prize which can be won on a scratch card is set at €1,750, and at least 25% of the proceeds from the scratch card sales must be allocated to an identified charitable or philanthropic cause.
- It is contemplated that lotteries operated in conjunction with a sales or marketing initiative will require a licence.

**Bingo**
- The Scheme proposes that lotteries and bingo will be separately regulated going forward – currently, bingo is considered to be a type of lottery game, and therefore subject to the same rules applying to lotteries.
- The rule that bingo must always be for charitable or philanthropic purposes is being relaxed, but a link to local interests will be required in most instances. According to the proposals, there will be a cap on the amount of bingo proceeds which can be allocated to overheads, and minimum percentages which can be allocated to prize money.

**Gaming and Amusement Arcades**
- There will be 2 separate categories of

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licence for gaming arcades and amusement arcades: a “gaming arcade licence” and an “amusement arcade licence”. The Scheme contemplates that amusement machines may be provided in a premises which is operated under a gaming arcade licence, but where an arcade contains both amusement machines and gaming machines, then a clear physical separation between the two types of machine will be required.

Remote Gambling
- “Remote gambling” is defined in the Scheme as gambling in which persons participate by the use of remote communications. The term “remote communications” is defined as including the internet, telephone, television, radio, or any other kind of electronic or other technology for facilitating communication.
- While it is contemplated that all forms of gambling by remote means will be licensable, the Scheme provides very little detail in relation to the proposed categories of remote gambling licences, and this aspect of the proposals requires significant clarification.
- As outlined above, a number of specific licences for remote betting activities will be available: remote betting licences ("category 1E"); betting exchanges ("Category 1I"); spread betting licences ("Category 1J"); and pool betting licences ("category 1K").
- The Scheme provides for two types of "remote casino licences": a “category 2O” licence for “remote casino services” and a “category 2P” licence for “support services in the State for a remote casino”. It is not clear from the Scheme what activities will constitute “remote casino services” and “support services in the State for a remote casino”, and this will need to be clarified.
- A specific “remote bingo” licence is also proposed (a “category 2Q” licence).

However, no specific “remote lottery” licence is provided for, although the definition of “lottery” includes the playing of lottery games by means of remote communication, so it is to be assumed that lottery licences will allow for the remote sale of lottery tickets.
- The Scheme also lists two types of “mixed remote” licences where both gaming and betting are provided together – a “category 3A” licence where the service provider is in the State and a “category 3B” licence where a support facility is located in the State – but no further detail on these licence categories has been provided at this stage.

Player Protection
One of the key principles underpinning the proposed new legislation will be player protection, and the Scheme contains a number of proposed safeguards, designed to ensure that the new regulatory regime achieves its stated protection purposes of ensuring fairness; protecting vulnerable persons from the risks of gambling; keeping gambling time-free; and ensuring consumer protection and choice. By way of example:
- Licence holders will be subject to a series of “responsible gaming” obligations.
- It is proposed that the OGCI may specify that certain machines, or classes of machines, or games (including games played remotely), may only be played using special “player cards” (i.e. a unique card (or code) that a customer will be required to obtain from the operator to access a certain game or machine).
- A “self-exclusion register” will be established for persons with gambling problems.
- A “Social Fund” will be established, which will be used to fund the promotion of socially responsible gambling and to assist in counteringact the ill-effects of irresponsible gambling. It will be funded from contributions by licence holders.
- It is envisaged that the OGCI will be able to attach specific terms and conditions relating to social responsibility to the gambling licences issued by it. For example, it is proposed that the OGCI will be able to make it a licence condition that a licence holder introduces and maintains systems for monitoring players whose pattern of gambling gives reason for concern.

Conclusion
In terms of next steps, a parliamentary committee has been appointed to consider the Scheme, and has invited written submissions from interested parties by 30 August 2013. Although the Scheme provides a good starting point for Ireland’s new gambling regulatory framework, clarification will be required on a number of points, and significant modifications will be required if Ireland is to produce a workable and efficient regulatory model.

The proposed introduction of a registration system for companies which establish gambling operations in Ireland, even where they do not target Irish players, seems like a sensible proposal.

The publication of the Scheme comes at a time when other Irish Government Departments are addressing other specific areas of the gambling sector. Following the enactment of a new National Lottery Act in May 2013, the Government has launched a competitive process for the award of a 20 year licence to operate the Irish National Lottery. This process is currently underway, with a deadline for the receipt of applications of 16 September 2013.

While the National Lottery, and the legislation governing it, will remain separate to the Gambling Control Bill, the Department of Finance has recently republished the “Betting (Amendment) Bill”, which is intended to introduce a licensing (and tax) regime for remote bookmakers and betting exchange operators taking bets from Irish punters. Any licensing regime introduced by this legislation, if it is enacted, will no doubt need to be revisited in the context of the Gambling Control Bill, which is intended to regulate all forms of gambling, including betting.

Indeed, if Ireland takes steps to regulate online betting in isolation from other forms of gambling, this arguably lacks consistency. As the reform process finally gathers pace, Ireland will need to keep a watchful eye on Luxembourg, and to be conscious of adopting a consistent and systematic approach to regulating (and taxing) different forms of gambling.

In any event, it finally appears that Irish gambling regulatory reform is gathering pace. With an election due to be held in 2016, the smart money is on the Gambling Control Bill being enacted into law in late 2014/2015.
Online casinos were among the first gaming sites to appear on the internet when they launched in the mid-1990s thanks to the pioneering efforts of software companies. During the course of the past decade, the digital casino market (encompassing websites for computers, mobiles and other connected devices) has grown out of all recognition, maintaining its position as the leading gaming genre in terms of numbers of sites.

_Digital Casinos: A Market Assessment and Outlook_ examines the main issues surrounding the growing digital casino industry.

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BINArY OPTIONS: The Licensing Debate

R Paul Davis, LL.D. ¹

Introduction
Attendees at any of the world’s major gaming or affiliate shows (ICE, EIG, LAC) cannot have failed to notice the proliferation over the last two years of financially based operators, including “Forex” but mainly binary options companies. Some of the tradeshows stands have been spectacular and the apparent marketing budgets are impressive. At the last LAC³ – London Affiliates Conference, a rough impression is that half the stand space was devoted to these products; they arguably had the most striking stands and boasted some of the best-turned-out representatives.

Despite the pervasive presence of binary options operators in the gaming marketplace, however, leading figures in the industry proclaim strongly that binary options are not “gambling” products at all, but “financial services” Consumers of the product are referred to as “traders” while the technology companies call themselves “platforms” and the operators “brokers.” This portraiture in the financial services mode has profound implications for licensing practices and consideration of the legality of offerings. Around the world, governments and regulators are taking diverse approaches; the end game remains obscure in several jurisdictions. As a prelude to the live debate to be held at the IMGL Conference in Oslo, the following will set the scene and summarize the current position.

What are “binary options?”
Binary options aren’t new. They were invented as an investment product around 1908, in Chicago, but the mathematical calculations surrounding them were developed in the 1970s. The most notable mathematician and scholar involved was by Myron Scholes, a Canadian, who won a Nobel Prize for his work.

“Binary,” because there are only two results possible for the trader’s prediction (right or wrong) on a market movement: “0” or “1” in computer language. For example, the trader might put money on the table and speculate that a stock will rise to a specific value by, say 3 pm today. Either it does, or it doesn’t. If it does, the counterparty or operator pays out up to 85% of the original stake and returns the stake money. If it doesn’t, most or all of the stake or investment is lost. Of course, as with all mature financial products, there are many and subtle variations on the basic product. One popular variant is the “one touch” binary option, where the trader bets not on the final result at a defined time, but on whether the price of the subject commodity will touch a certain price before the expiry of a period of time. One touch, and the trader is paid out; no touch by the end of the period, and the stake is lost. In sum, though, the underlying asset or commodity is never owned or delivered by any party to the transaction; there is merely a financial relationship based on market prices.

Trading in binary options is thus a form of financial gambling, and in that simple statement lies the million dollar question. Is it gambling, or is it financial trading? It’s possible to argue that longer term plays are financial investments, because some skill is involved in predicting the future of a market (just like a stock, currency or commodity). Of course, skill can be involved in some activities which no-one disputes are gambling, such as betting on the outcome of a sporting event. Indeed, outside of the on-line entertainment environment, there is a legitimate place for binary options in the commercial world as an instrument for hedging future positions of commodities or currencies. Very short term options, however, look more like gambling because, as prices move in a zigzag pattern and not a straight line, what happens in the next minute or five is an unpredictable, uncontrollable event. In terms of trader experience, too, there is a marked contrast between, for example, a CFO calmly purchasing an option to expire at the end of the year to hedge a currency position, and a private individual sitting down to place a stake on 15 minutes

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² Traditionally “Foreign Exchange” refers to the commercial activity of exchanging one currency for another. However, “forex trading” which bears some similarity with “day trading” on the stock market, has become a popular form of internet speculation where amounts are staked on the direction of movement between two currencies, rather than the actual exchange of one currency for another. There is close intertwining of the “forex” world with that of binary options, with many companies offering both products.
of movement and gaining a similar adrenalin rush to watching a horse race or a football match with money staked on the result.

Binary options are traded on stocks, options and futures markets (for example, the Chicago Board Options Exchange and Amex – The American Stock Exchange1) and are seen in many places as financial instruments. However, they’ve been popularized in the last couple of years by some very aggressive, very clever, mainly Israeli enterprises, largely using Cyprus-based companies. Aside of a handful of independents, the supplier marketplace consists of five major “platforms” – software providers who have turnkey solutions for offering binary trading on the web. These have the best part of 300 “white labels” – essentially risk-taking marketing B2C companies who promote the software of the platforms on branded sites around the world, usually in return for a setup fee and a profit share. The largest binary options platform, SpotOption, claims to support 65-70% of the world market. All five major Israeli platforms are well funded, professionally run, and have massive transactional volumes. However, the majority of operators using them are presently unregulated, meaning there is no protection of investor funds and no market oversight of their offerings and practices. The options are traded “over-the-counter,” direct from seller to buyer, and the customer requires little or no knowledge to participate. Naturally the operators attempt to offer their “odds” on an algorithmic basis so that they show a net gain for each day’s trading.

The financial problems of Cyprus have caused both platforms and operators (“white labels”) to re-think their dependence on the country, its banks, and importantly its licensing authority (CySec2). Increasingly they are looking towards Malta, the Isle of Man, and possibly other places, for their global regulation and credibility, while engaging in discussion with regulators regarding national licensing. This is remarkably similar to the gaming environment of today, and begs the question as to which body, where gambling and financial services are licensed by different authorities, should issue the licence and be the regulator.

**Why is the distinction important?**

Competition in the binary options marketplace has made regulation, with the attendant marketing opportunity, an attractive haven for many operators. The jurisdictions of choice for licensing have clearly debated, and in some cases struggled with, the distinction, with varying results as explained below.

However, there are two much more subtle and compelling reasons why binary options operators really, deeply want to be considered purveyors of financial products. The first relates to payment card processing. If a binary option is a gamble, then the all-important MCC – Merchant Category Code – assigned by the card schemes3 is 7995. This is a restrictive code blocked by many issuing banks, particularly in countries like Norway and the USA, where internet gambling is largely or wholly illegal. If however the deposit transaction when a trader funds his account is a financial investment, then the merchant is able to apply for use of MCC 6211, “Security Brokers/Dealers” or even 6051, “Non-FI Money Orders.” The relative likelihood of approval for a transaction even for a country where gambling is legal, such as Spain, is significantly higher; in countries where gambling is prohibited and payments methods are targeted as a means of control, the difference is between virtually guaranteed failure of a transaction, and a strong possibility of success.

Secondly, religious, cultural and legislative differences open or close markets for the operators. Binary Options are popular in the Arab states, where gambling is illegal under secular and religious laws. Binary companies are keen to offer their services in the lucrative markets of Saudi Arabia, Qatar, the Emirates and others, but can only do so if they are offering financial services. Obviously construed as a gambling product, taking customers for binary options would be difficult at best and largely impossible when considering the payment aspect.

**How have different jurisdictions approached the problem?**

The starting point for consideration in a European context is of course MiFID. Section C of Appendix I sets out a list of “Financial Instruments” and, while it does not mention binary options by name, includes:

“(4) Options, futures, swaps, forward rate agreements and any other derivative contracts relating to securities, currencies, interest rates or yields, or other derivative instruments, financial indices or financial measures which may be settled physically or in cash.”

From the point of view of operators within the EU, this looks like a slam dunk, clear end to the debate. Binary options fit this definition squarely, and the force of MiFID then comes to bear; firms offering binary options to the public are required to be authorized and regulated in their home state (the state where their registered office is located). This is a departure from the previous situation under the ISD where regulation was required where the activity took place. From the point of view of an operator with branches in several countries it is a welcome improvement, for it opens up the possibility of passporting the authorization throughout the EU and EEA.

Within the EU, implementation of MiFID in respect of binaries is at different stages. Elsewhere however, different approaches have been taken. Here follows a review of the situation in some of the principal jurisdictions where serious consideration has been given to the issue.

**Cyprus**

Cyprus has the distinction of having been a first mover in this area, and arguably of having the clearest legislation on the issue. Binary options, beyond doubt, are financial instruments in Cyprus, and regulated accordingly. All Cypriot firms offering binary options are required to bring their activities within the ambit of the regulator alongside other investment company requirements. What has however muddied the waters considerable is the establishment of a series of delaying and grandfathering provisions, which have essentially allowed Cypriot firms to continue offering binary options while their applications for licence issue or modification are pending. At the time of writing most Cyprus operators who have applied for licences are “in limbo” pending determination of their applications, but are freely permitted to continue to offer products despite the not-yet-determined status of their licence applications. A Cyprus licence remains a valuable prize, despite the economic difficulties of the country.

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1 London Affiliates Conference, 7-10 February 2013, http://www.igbaffiliate.com/events/ londonaffiliatesconference/schedule
2 Where they are referred to as “Fixed Return Options.”
3 Cyprus Securities and Exchange Commission.
4 Visa and Mastercard; principally American Express does not permit gambling transactions to be paid for using its cards.

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because Cyprus is an EU country but with relatively liberal compliance and taxation requirements; however, there is massive unwillingness to place money with Cyprus banks and this is a heavy disincentive. The regulatory deposit requirement has been clarified to reduce this disincentive, and licensees can hold their collateral outside the country; however, the ability to act as a broker while the application is pending means that many brokers have incurred the relatively low cost of applying, but may not actually proceed to full licensing which is more expensive and burdensome. The situation remains changeable and unsatisfactory.

Isle of Man
In this prominent jurisdiction for gaming regulation, two brokers have applied successfully for gambling licences under OGRA and are up, running, and enjoying success as regulated gaming operators. That is not the end of the story, however, as the banking and governmental difficulties in Cyprus have sent many Cypriot-based brokers looking for a more stable licensing jurisdiction. Several have approached the Isle of Man with a desire to move their operations and take licenses from the Financial Supervision Commission. An initial rejection of these overtures by the FSC, apparently largely on the basis that it didn’t have the resources to regulate binary options, has turned into a protracted discussion about a possible hybrid approach where FSC issues licences, but the GSC with its knowledge of the marketplace and procedures provides regulatory supervision on a sub-contract basis. This is a novel approach but one which could pay huge dividends for the island as hundreds of jobs could quickly move there.

Japan
Japan is of major interest to this debate. It is the world’s most avid consumer of Forex products on the internet, with some commentators suggesting that there are more domestic Forex traders in Japan than the entire rest of the world. Despite lower limits, it is probably true that the net volume of Forex trades in Japan exceeds all other countries combined.

Binary options trading in Japan is presently unregulated, and a demonstration that there is no notion of criminality is evident in the physical presence of representative offices of major platforms such as SpotOption. Were there any fear of prosecution no doubt the offshore operators would stay physically away from Tokyo real estate! However, legislators and regulators are aware of the growing presence of the product and serious review is under way by two bodies, the governmental Japan Financial Services Agency (JFSA) and the self-regulatory body the Financial Futures Association of Japan (FFAJ). Speculation in the Japanese press and elsewhere is that a framework has already been agreed, and that rule changes are likely to forbid certain types of options. Most significantly, very short-term and high/low type options are likely to be prohibited, as the authorities see these more as gambling than financial activities. Summer of 2013 was set last year as a target date for completion of the regulatory exercise, though at the time of writing there has been no announcement. Leading representatives of the industry have been engaged in continuous consultation with the drafters and movement is expected soon.

The effect of such regulation is likely to be twofold: first, it is likely to cause a significant reduction in volumes traded and profitability for brokers; second, it is likely to perpetuate a black market in the most popular types which afford the best adrenalin rush for traders!

Malta
Binary options in Malta have undergone a transformation from gambling to Financial Services. In the wake of the Cypriot crisis, considerable interest was shown by many firms in moving their operations and licensing to Malta. Previously subject to licensing by the Lotteries and Gaming Authority, on 18th July 2013 the Maltese Financial Services Authority announced that it was taking the view that binary options fell under MiFID and that it would seek to licence and regulate operators under the Investment Services Category 3 licensing regime. An agreement was made to transfer responsibility for existing LGA operators over to the MFSA and work is under way. Binary options, which once appeared to be gambling products in the Maltese environment, are now Financial Instruments. Malta is likely to emerge as a significant base for Israeli-owned binary enterprises, as it has the attractions, not to be under-rated, of a warm climate, relative proximity to Tel Aviv, an English-speaking population, and a large gaming sector with customer service experience. The capital requirements for investment companies in Malta are by contrast likely to be a disincentive for smaller brokers.

Turkey
Turkey has been a popular market for binary options operators, being a country where most forms of gambling are strictly controlled and limited to government monopolies. The irony of Turkey’s aspirations to EU membership coupled with its stark opposition to private sector gambling is noteworthy. Historically, Forex trading has attracted the attention of the Turkish Capital Markets Board (“CMB”) and from August 2011 local licensing was required for all brokers. Since then the number of licences granted to Turkish Forex companies has reached into double figures, but around two dozen foreign operators departed or switched to binary options, believing that binaries would be of limited interest to CMB. Not so, in mid-2012 the regulator issued a bulletin in which it accused unlicensed brokers of criminal activity and required internet service providers to shut down several IP addresses related to binary sites. Implicit in the CMB’s ruling is the notion that it does not consider binary options to be financial instruments but rather gambling products. At least two Turkish brokers appear to have shut down since, although foreign based operators still appear keen to offer products into Turkey if they can solve the payments issues.

The United States
It’s easy to make the bold statement that binary options trading is legal in the USA - just like driving a car, if you have the required licence and equipment! Futures have been regulated at a federal level in the US for over one and a half centuries, and the body with official oversight is the US Commodity Futures Trading Commission. The CFTC has issued a licence, for example, to NADEX (the North American
Derivatives Exchange) to deal in, inter alia, binary options.

It is one thing to have official exchanges brokering derivative type instruments between individuals. However, the real questions relate to over-the-counter offerings, and offshore operators selling into US markets. There is no doubt as to the federal government’s position on unlicensed offshore operators; in June 2013 both the Securities Exchange Commission and CFTC took legal action against a large Cyprus-based operator, Banc de Binary. The regulators filed civil suits in Nevada, charging violation of prohibitions on off-exchange options trading, and illegal operation of an unregistered futures merchant. The penalties sought are monetary and injunctive. This followed similar actions against Irish operator InTrade at the end of 2012; subsequently InTrade appears to have gone completely out of business.

It is interesting to note that the US government has not taken any stance that binary options are gambling products; the implication is that with appropriate licensing in place, the SEC and CFTC are entirely happy for these instruments to be offered to the public. From this it can be concluded that US legislators are content that they are Financial Instruments. This is further underlined by absence of the DOJ from the above proceedings; there is no allegation of criminality and no reference to gambling legislation. The situation remains analogous to that in the online gambling industry, where indictments have been preferred against a handful of major operators while approximately 3,000 sites remain available to the American public. For binary options, two major enforcement actions are under way while Americans continue to have access to over 100 offshore providers.

In Summary
By a show of hands, the world is moving inexorably in the direction of voting binary options to be financial instruments. Turkey stands somewhat alone in seeking to criminalize their offering as gambling products; the Isle of Man and Malta have historically granted licences in the gaming environment, but Malta has turned 180 degrees to assume all responsibility in the Financial Services sector, and the Isle of Man looks poised to move strongly in the same direction. MiFID appears clear on the issues, Japan and the United States are in no doubt, and in other smaller countries legislative control has come from the financial sector.

But are they right? In poker, there is a strong argument that traditional forms are games of skill. Some variants, however, appear to have no element of skill and could be construed as pure games of chance, where the player has no element of control and no amount of skill can affect the outcome. Could the same be said for binary options, where longer term plays fit settled notions of investment but shorter term speculation looks like a pure gamble? Is trader behaviour an indicator of which side of the line the product falls? Certainly the very short (one minute) plays and the widespread availability of over-the-counter binary options has moved the clientele from the financial community to the entertainment arena. Is there value in the “one size fits all” designation of binary options as either gambling or financial, or should there be consequences from the conclusion that some forms fit one definition while others are best viewed as gambling products? If so, who is to draw the line and who is to regulate?

Just as, in the sports betting world, in-play betting with its shorter time frames and fast resolutions has become highly popular with the public and the operators, shorter term binary options find great favour with brokers because they allow faster churn of greater amounts of money. The dilution of skill content coupled with algorithmic offering allows for greater profitability. A long term binary option purchase looks like a stock market investment. A short term binary option purchase looks a lot like an in-play bet. How is the world of binary options to be regulated in the long term, or is it a passing fad that will recede into the background when the “next big thing” arrives to consume the passions of internet gamblers? The author offers, with humility, the suggestion that regulation from either sector is a good consequence from the conclusion that some forms fit one definition while others are best viewed as gambling products. If so, who is to draw the line and who is to regulate?

In the financial services sector, and the Isle of Man looks poised to move strongly in the same direction. MiFID appears clear on the issues, Japan and the United States are in no doubt, and in other smaller countries legislative control has come from the financial sector. If so, who is to draw the line and who is to regulate?

The Risk Management team at FirstData, which has a massive presence in the gaming world, has recently declared an interest in participating in card processing for binary options, and has expressed a preference for dealing with licensed operators. Yet, despite the majority of licensing activity being in the financial services sector, it has also ruled that for the time being, all transactions must be coded 7995 (the gambling code). Such restrictive policy with the major brokers leaves emerging businesses at the mercy of less scrupulous acquirers and, in extreme circumstances, might even lead them to mis-coding of transactions through a grey area acquirer. It further exposes them to very high pricing (but 90% of $100 is better than 98.5% of nothing). Our profession can play a leading role in arguing the appropriate best practices for both industry participants and their payment product providers.

R Paul Davis is the Managing Director of Counting House (IOM) Ltd., a payments and cash management consultancy based in Douglas, Isle of Man. Comments and correspondence welcome: paul@countinghouseltd.com
Regulator & Industry Collaboration: Changing the Dynamic

by Susan Hensel,
President, IAGR & Director of Licensing, Pennsylvania Gaming Control Board

In October, my second term as President of the International Association of Gaming Regulators (IAGR) will expire and Lau Peet Meng, Chief Executive, Singapore Casino Regulatory Authority will take over the helm. In my time as President, thanks to the work of a dedicated Board of Trustees, IAGR has made significant progress in establishing itself as the premier international regulators association in the world. In coming years, the association will continue to play an important role in the future of gaming as the industry and regulators increasingly recognize the importance of communication between the regulator and the regulated.

Driving this recognition are factors such as globalization and technological change that have put the gaming industry in an accelerated state of evolution. There is no longer the luxury of time to resolve emerging issues. The advent of mobile phones, tablets, and social media is raising new questions. Today those questions are moving to the forefront of regulator responsibility and industry opportunity.

While we all recognize that we are operating in a very different gaming environment than even a few years ago, the question is how can regulators and the industry move beyond the long talked about need for collaboration to actual collaboration? How can we advance industry and regulatory initiatives independently underway to achieve results?

While there may not be ready answers to these questions, there are factors at play in the industry today that set the stage for exploring new approaches.

With more of the same companies operating in multiple gambling jurisdictions, there are more chances for regulators to work together in their investigation and evaluation of gaming companies. Informally through professional relationships developed as a result of organizations such as IAGR and formally through memoranda of understanding, regulators are able to share information with one another and cut down on duplication of effort. We will see more occasions for cooperation as the concept of inter-jurisdictional gambling compacts grows and participants gain experience in how to regulate efficiently multi-jurisdictional relationships.

Also helping to drive smarter regulation is the very technology that is bringing about change. These advances have given us tools that simply were not available before. Thanks to technology, we are better able to develop targeted, risk-based regulation that provides public protection assurances while saving time and money. Today, we can see what we couldn’t see. We can control what we couldn’t control. We can send data around the world with a speed that is near instantaneous. And we can communicate across continents as if we were sitting next to one another. These abilities are transformative.

Compare a jackpot dispute in the days of crude slot machines with one that occurs today. Then, it was a matter of player versus operator – a “he said, she said.” Today, there is a digital audit trail of all machine activity that puts an end to any dispute.

Then regulatory staff was mandated to oversee the slot count; today central control computer systems keep track of every penny, eliminating the necessity for regulators in the slot count room. Then there was fear that online and mobile capability would be a loophole for underage gamers, but now fingerprint technology and other biometrics offer the prospect of immediate verification that the player is who the player says he is and is not an underage gamer. These assurances ease regulator worries and help open new markets. Then casino staff memorized thousands of faces on exclusion lists with the hope of being able to spot an intruder. Today facial recognition software is being explored. And then, investigators had no alternative but to travel in order to ensure applicant suitability. Today some jurisdictions are experimenting with video conferencing to reduce the time and travel expense of some background investigations.

IAGR has set a goal for itself to be a thought leader in improving gaming regulation and has undertaken new initiatives as we work to accomplish that goal. We are launching a pilot program of our multi-jurisdictional business form so that operators can use the same material for applications in different member jurisdictions and can simultaneously update the information when necessary. We are exploring opportunities for making remote gaming test results transferable across jurisdictions, reducing cost and time to market for new games. We are also considering what can be done to develop standards in the non-remote sphere. Within our portal we are developing an IAGR knowledge module so regulators can share

Susan Hensel
best practices, discuss emerging issues and collaborate on solutions. And we are undertaking creation of a statistical database providing a knowledge asset available to regulators and those advising the industry.

Finally, we are recognizing the important role IAGR can play in acting as a focal point for industry bodies such as the Gaming Standards Association and the American Gaming Association (AGA) and for regional bodies such as the regional gambling regulatory associations like Gaming Regulators European Forum (GREF) and North American Gaming Regulators Association (NAGRA). By establishing these relationships, we are putting interested people or organizations in touch with the people who can help make things happen.

But IAGR, just like the industry, can only do so much by itself to achieve a smarter regulatory environment. In order to truly make a difference, we need to be working together. There are very real difficulties in getting a sustained effort underway to improve the way in which we work. Part is the reality of pressing job demands that provide little opportunity for abstract thinking about how to accomplish long talked about objectives. Part is that despite good intentions, it just plain hard work to deliver on lofty goals of cooperation and collaboration that are made from conference podiums.

The challenge for the regulator and industry is to find and exploit opportunities to think differently about how we interact with one another, to find a way to change the dynamic. We need, for instance, to be talking to one another about how we can promote discussion between conferences. It sounds good, but how do we actually set about making those conversations a reality?

We also need to think differently about how we use technology. How can we leverage the exploding technological options to do things better? Can we, for instance, leverage webinars, blogs, and social media sites to efficiently share information and learn without having to book a flight or leave our offices? Instead of our primary focus being on knowledge sharing from our colleagues, whether regulator or industry, can we tap into one another across classifications? Can organizations like International Masters of Gaming Law (IMGL), International Association of Gaming Advisors (IAGA), and AGA share information with associations like IAGR, GREF, and NAGRA? Can we, for instance, establish knowledge banks across organizations rather than just within associations? And if so, how exactly do we set about making that work?

As I prepare to end my term as IAGR’s President and transition to an IAGR trustee, I leave you with these questions. IAGR looks forward to working collaboratively on the answers that will lead both industry and regulator to a place of better regulation in the future.

SUSAN HENSEL, President, IAGR & Director of Licensing, Pennsylvania Gaming Control Board. Email: shenseljar@state.pa.us

The Changing Face of Payments
A Market Overview and Global Trends

Key Features
- Comprehensive overview of the global payments ecosystem
- Review of geographical process and behaviour surrounding payments, as well as looking at local licensing across Western Europe, and emerging and growing markets in Eastern Europe, Latin America and Asia
- An analysis of how the availability of more convenient options are creating new opportunities for alternative and non traditional payment
- Learn about different payment methods: credit and debit cards, mobile, NFC, Ukash, PayPal
- Review of regulation and recent changes made by SEPA (Single European Payments Area) and PSD (Payment Services Directive)
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Introduction

In recent years land based gambling operators in the US have experienced increased interest from hedge funds and capital investors who are looking for new and attractive investment opportunities. Primarily, these funds and investors are seeking growth stock, as opposed to dividend company stock. While it is still a subject of discussion in the United States, the landbased industry has been present for a very long time and has developed into a fully legitimate industry with high level of control and strict compliance regulations.

The industry has also improved its image, the image of the products that it offers. A trip to a Casino to gamble is now accepted as a legitimate kind of adult entertainment for everybody, and not limited to people with gambling problems.

Further, the fact that many of the largest players in the industry are now listed on the stock exchange, as well as the active role that some of the casinos have taken in their local communities, e.g. the role the casinos took in the south in the days and months after Hurricane Katrina hit the area around New Orleans with emergency housing and rebuilding of the community, has helped the landbased gambling industry's image in the US.

The general acceptance of the industry helps to explain investors' interest in capital investments into the industry.

Similarly, for more than a decade some of the largest players in the European online gambling industry have been listed on stock exchanges around Europe, and the European online gambling industry has long been run by very professional entities. However, the fact that online gambling was prohibited under national law in most European jurisdictions has delayed the broad and general acceptance of the European online gambling industry in public opinion in Europe as a legitimate entertainment industry.

The wave of legislative reforms in this area throughout Europe is now beginning to work in the favor of the European online industry, and possibly in the near future make the industry interesting for capital investors as well.

The legislative reforms in Europe

Starting with Italy in 2006, Europe has experienced a wave of legislative reforms in the area of remote gambling. The models chosen are all different but all reforms have in one form or another allowed for privately owned operators to offer their services of online gambling and betting either instead of or parallel to the state owned (former) monopoly operators.

And since Italy initiated the process of legislative reforms jurisdictions like France, Spain, the Netherlands and Denmark have joined the club of European jurisdictions where privately owned entities can offer betting and online gambling. Although Germany has decided not to allow the offering of online casino games and poker, but limit the German reform to betting, Germany is the latest European jurisdiction to join the trend of opening the gambling market for private operators.

One of the most important parts of the legislative reforms is the access to marketing for their gambling operation that is granted to private operators, who have been granted a license to operate in a given European jurisdiction. Most jurisdictions have secured various other measures, such as payment blocking and ISP-blocking to keep out non-licensed operators from the market. But not only are payment blocking and ISP-blocking very expensive due to the necessity of involving the court system, but they are also slow and often prove not to be very efficient if they work at all. However, allowing the licensed operators to advertise makes it very difficult for non-licensed operators to build a brand and to gain customers and market shares, since the non-licensed operators will not have access to marketing through the traditional and local marketing channels. Indeed, the control of advertising is central to the United Kingdom's forthcoming reforms, with the legislative changes not including any ISP or financial transaction blocking measures at this time.
The right to advertise gives the licensed operators the ability to build brand awareness and acceptance for private operators in the public opinion, and slowly but surely the offering of betting and online casinos is being recognized as legitimate adult entertainment, and no longer something illegal which should be avoided.

Is Online gambling interesting for capital investors?
It is a general misperception of the gambling industry that the operation of online gambling is like printing money. There are many operators available online and the competition is only a few clicks away. Further, because many people including politicians still believe that it is easy to make a lot of money with little effort in the online gambling industry, the revenues derived from betting and online gambling are heavily taxed. Finally, and possibly due to the history of the gambling industry and its previous links to organized crime, the licenses and the operation of betting and online gambling are subject to detailed regulation and strict supervision and control from the local gambling boards.

In other words the industry is faced with a high level of taxation, high expenses on compliance and low margins as a result of strong competition.

This being said the operators that know their business and run a smooth and professional operation are making money. The bigger operators and operators that have been established for a longer period of time and consequently have a known and popular brand, do generate profits that are indeed attractive for investors.

With the legislative reforms in Europe, the industry is beginning to enjoy much higher levels of acceptance as a legitimate entertainment industry. This also means that the number of potential customers for the private operators increase. As people begin to realize that betting and playing casino games and poker online is not illegal, and that licensed operators are under supervision of the national gambling control board, they conclude that it is safe to play. The former monopoly operators typically are offering fewer and less interesting products at a higher price than the private operators.

Yet, in certain European jurisdictions private operators face huge challenges coping with competition from the state owned former monopoly operators. This is not due to the state owned operators’ ability to run their operations at a more profitable level, but simply because the state owned operators have been given a huge and unfair competition advantage.

In Denmark the state owned operator, Danske Spil, has been forced to split its operation between two different companies: one company to offer the games on which Danske Spil continues to enjoy a monopoly (horse race betting, lotteries and bingo) and another company to offer the games that are open to private operators as well. However, the Danish authorities allow Danske Spil to use the same brand for both companies. This allows Danske Spil to contribute most of the brand awareness marketing costs to the monopoly company where the margin is not under pressure from competition, giving the licensed games company an unfair advantage against the private operators on the market for licensed games. The authorities have also allowed Danske Spil to cross sell their licensed games to the customers in their monopoly games customer database.

Competing with large state owned companies requires a considerable amount of money. Although public opinion is changing in favor of the industry, banks and other financial institutions have proven reluctant to get involved with the online gambling industry, despite the fact that licensed operators are legal and regulated.

However, for political reasons banks, at least in Denmark, refuse to have online gambling operators as customers with Danske Spil as the only exception. This approach from banks and the lack of access to opening a Danish bank account means that it is more difficult for operators licensed in Denmark to provide optimal customer service to their Danish customers.

With increasing levels of competition and increasing costs for taxes and licenses, it is not unlikely that at least some operators will need external capital to maintain their ability to compete in terms of securing customers through marketing and promotions and by developing and reinventing available products to keep their operation attractive to the market.

Current trends make the online gambling industry a good option for capital investors.

Capital investment in a gambling operator
As a consequence of the detailed regulations and compliance requirements, incorporated into most gambling legislation regimes, purchasing voting power and ownership in a gambling operator presents obstacles that are unknown to most other industries.

Many jurisdictions require licensing not only of the entity which is legally responsible for the provision of gambling services, but also of the key individuals that are part of management and/or who hold a certain size of the ownership of such entities.

Although licensing of individuals is not required yet under Danish law, the Danish gambling legislation also requires disclosure of ultimate beneficial owners and certain data regarding such individuals.

The Danish legislation sets two different thresholds. The first level is defined as qualified ownership and includes everybody with an ownership of 10 % or more. The second level is 50% ownership or more.

If a person owns more than 10% of the license holder/applicant, then that person must submit a personal declaration to the Danish Gambling Authority. The personal declaration must contain information of marital status, place of residence for the latest 10 years, some aspects of that person’s career and financial status and criminal record.

The same requirement applies for executive officers and board members in companies that own 10 % or more of the shares in a gambling operator licensed in Denmark.

If the 50% threshold is reached, additional financial information about the natural or legal person holding 50% or more of the ownership interest in the gambling operator must be submitted including operating budget audited annual reports covering the latest 5 years.

In situations where the above mentioned thresholds of ownership of a gambling operator, which holds a license in Denmark and which has already initiated operation in Denmark, are reached the new owner must be approved by the Danish Gambling Authority before the ownership title to the
shares in that gambling operator can be transferred to the new owner.

Such requirements as the ones described above are not unique for Denmark, but are a part of the gambling legislation in all European jurisdictions that offer the possibility of obtaining a gambling and/or betting license. There are as many different systems as there are jurisdictions, and the Danish legislation is one of the less demanding and strict in Europe, but none of the European jurisdictions are as demanding as some US jurisdictions.

The United States As An Emerging Market
In recent years, private equity firms have made significant inroads in the gaming industry in the United States. Perhaps the prime example of that is the controlling interest in Caesar’s by Apollo and TPG, two of the largest private equity funds in the United States. With the emergence of the online gaming industry, particularly in Nevada, private equity firms, primarily through acquisitions via the gaming firms they currently have interests in, are starting to have a presence in the online market. Again, Caesar’s is a good example as it expands into the online field. However, the private equity interest tends to be in more of a growth model, that is appreciation of the value of the stock, as opposed to a dividend or return model where investors are looking to receive profits from the earnings of the companies.

Since online gaming is in its infancy in the United States, it does appear that the growth model will become the primary model for online gaming companies in the near future. Thus private equity will likely be interested in participating in these online gaming operators.

Private equity and capital investors that are interested in acquiring an interest in operators and operators which are interested in ceding control or selling substantial ownership stakes to private equity entities, should be cognizant of the complex and varied regulatory environment in the United States. Operators are going to be licensed directly by a state or tribal entity which is going to require the regulatory entity’s approval prior to the change of control occurring. Even if the private equity and capital investors take a minority interest, or a passive interest, in the operator there may be licensure requirements or waivers required to be issued by the local gaming jurisdictions.

As most land-based casino operators and suppliers doing business in the United States are well aware, the licensure process in some states can be very thorough, even bordering upon onerous. Substantial financial records, criminal background histories, and interviews are the norm in most licensing jurisdictions if an entity is going to take control of an existing licensed operator or have a substantial controlling interest in such an operator. As online gaming is truly emerging in the United States, entities seeking to get in the field will go through what may in many cases be the first licensing experience for certain jurisdictions. This initial experience always entails a more thorough review which often is more time intensive and possibly more costly due to the relative lack of knowledge of the online gaming field in most regulatory jurisdictions.

As a result, private equity interests, which have not gone through the licensing process, need to be cognizant that investing in online operators in the United States will entail a substantial level of investigation and regulatory compliance. Similarly, an existing licensed operator, who has an interest in ceding a portion or all of control to private equity interests, will have to understand that there could be substantial delays in allowing those transactions to occur if the private equity operators have not previously been licensed in such jurisdiction.

Since the online gaming market is still small and new in the United States and is confined currently to intra-state gaming, it may take some time until economies of scale and the value of operators reach a point where private equity will have an interest in making substantial investments. However, if the federal regulatory climate were to change, either by action of Congress or through the judicial system, it is possible that the market may grow much more quickly and thus the appeal of investing in online gaming in the United States would dramatically increase.

Ultimately, online gaming operators and investors who have an interest in online gaming operators should be laying plans to expand into the United States market and in conjunction with the same, ensure that they work diligently to maintain positive public relation strategies and effective compliance strategies so that as the United States’ market opens up they will find licensure more easily obtained.

As is evidenced in the discussion above, the United States market is substantially behind the European market in online gaming, but as time and technology advance, it is likely that the US market will catch up and operators and investors need to be prepared for that occurrence.

Conclusion
With the opening of the European online markets the online operators are looking at better access to the European markets, but the price for this in increased marketing expenses, gambling taxes and high license fees places additional financial pressure on the online operators.

In a market where the banks and financial institutions are reluctant at best to accept the online operators as legitimate entertainment businesses the access to external capital is limited.

Until now this has not really been a problem, but with the increased costs of operation combined with increased competition, it cannot be excluded that some operators are forced to consider alternatives to the cash flow financed business model.

For capital investors around the world this might turn out to be an attractive opportunity to explore, much the way investing in land-based casinos in the United States have become common.
Novomatic Group is one of the largest integrated gaming companies worldwide and the leading producer and operator of high-tech gaming equipment in Europe. Founded by the industrialist Prof. Johann F. Graf in 1980, Novomatic owes its success to more than 30 years of experience and the commitment and creativity of 19,000 employees worldwide.

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For more information on these events, contact IMGL Executive Director Melissa Triplett at IMGLDirector@aol.com.

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