KPMG

cutting through complexity

23rd and 24th April 2015

KPMG eSummit Gibraltar

Report

cutting through complexity

Kindly sponsored by

CONTINENT 8 technologies

reliable innovation

A word from the Sponsor

A secure, transparent and constantly evolving centre of excellence for ebusiness, Gibraltar is home to some of the most reputable brands in eGaming today and one of ten hosting centres in Continent 8's global network.

Since beginning operations in Gibraltar in 2012, Continent 8 has enjoyed unprecedented demand for our hosting and networking services. From our unique datacentre, which is located 500 metres within the Rock of Gibraltar, we continue to invest in Gibraltar's eGaming and eBusiness communities and remain committed to providing a level of excellence as standard.

This year's Summit was testament to the agility and resolve, as well as the vast potential of Gibraltar's ebusiness community today. Continent 8 is proud to sponsor this year's KPMG eSummit report and we look forward to seeing you again next year at the KPMG eSummit Gibraltar, 2016.

Richard Ebbutt
Continent 8 Technologies

Introduction

For over twenty years, Gibraltar's simple eGaming philosophy of assuring robust, sensible and proportionate regulation and a real bricks and mortar presence from quality operators has resulted in its becoming amongst the most trusted and envied jurisdictions in the world.

Today, Gibraltar is home to over 3,000 gaming sector employees, over 34 licensees and a complementary cluster of ancillary service providers, creating a community of excellence in ebusiness as well as a fast paced and exciting, world-reaching economy. Indeed, as the Gibraltar Government, the GBGA and a host of public and private sector stakeholders together embark upon a review of Gibraltar's gaming legislation and regulation; Gibraltar's future as a leader in technological advancement and consumer protection which is at the forefront of any regulatory regime in the world, is assured.

On the 24th and 25th April, 2015, over 240 delegates boarded the Sunborn Gibraltar to join KPMG for the fifth in a series of eSummits in Gibraltar and a two day programme of 40 world class presenters. Together, they discussed not just the future of the eGaming industry, but also its leading role as part of a global digital economy.

The Hon. Albert Isola, the Gibraltar Government's Minister for Financial Services and Gaming kindly opened proceedings by expressing Gibraltar's firm and total commitment to transparency and exchange of information, whilst celebrating its success in remaining a compliant, cooperative, business friendly and consumer focused jurisdiction. Gambling Commissioner Phill Brear then took to the stage with an introductory overview of Gibraltar's gaming economy before moderating a comprehensive panel review of gambling regulation in Gibraltar with particular emphasis upon the process of updating Gibraltar's Gambling Act 2005 and licensing arrangements to create an enabling legal and regulatory framework.

Eris Industries's Preston Byrne took over for the summit's first coffee and conferencing session with a fascinating discussion of the countless potential applications of the Blockchain 2.0 in today's digital environment after which MasterCard's Andrew Johnstone followed as moderator to a distinguished panel of payment specialists who together tackled emerging payments in their form, application and function. Following lunch, Peter Howitt of the GBGA moderated an exciting and frank panel discussion on the role of social responsibility in gaming where esteemed panellists, including representatives of the Senet Group, shared their thoughts on stakeholder responsibility, the role of the media and politicians, and as a closing note, the importance of public industry collaboration on the matter.

Tim Stocks of Taylor Wessing took over with a highly informative presentation entitled "Red Carnations and Slaying Dragons" in which the public markets specialist provided his audience with an evaluation and forecast of M&A and overall market activity within the global eGaming sector. Mr Stocks was followed by Paul Lasok, QC whose coffee and conferencing presentation allowed unparalleled insight into the implications of Fiscal Neutrality and VAT in the European Union from an individual well placed to discuss the issue. A final panel session, moderated by Peter Montegriffo of Hassans, closed Day 1 with a discussion on the evolution of gambling from the particular perspective of the operator at a 'point of reflection' for the industry.

Day 2 saw delegates return to the Sunborn to be welcomed by KPMG's Head of eBusiness, Archie Watt, following the previous evening's gala dinner hosted by the Government of Gibraltar at St Michael's Cave. The evolution of gambling, this time from the regulator's perspective, was the first topic of discussion as the panel of regulators Phill Brear, Hakan Hallstedt and Jenny Williams, moderated by IMGL President Joerg Hofmann, debated the importance of regulator personality, accessibility and independence. Conference regular Paul Leyland then took over to deliver the penultimate presentation entitled 'The Multi-channel Value Equation' in which Mr Leyland contemplated the benefits and disbenefits of the industry's latest focus: omni-channel presence. Providing the final presentation of the summit were Martina King and David Excell of Featurespace, whose captivating presentation narrated the company's development from a Cambridge University laboratory experiment to a critical provider of big data analytics, analysing its deployment and huge potential within eGaming and ebusiness.

This year's summit represented an evolution of the traditional format to also include four additional break-out sessions in parallel to the main programme. The International Masters of Gaming Law (IMGL) returned to provide two Masterclass break-out sessions both of which left standing room only as delegates rushed to find out more about the M&A environment for eGaming and the European legal viewpoint. The Gibraltar Betting and Gaming Association (GBGA) meanwhile ran the first of its responsible gambling seminars, a key topic of the day, while later in Day 1 a blockchain, cryptocurrency and FinTech commercial workshop set the tone for an afternoon's insight into the future for ebusiness transactions.

This report seeks to provide an insight into the event's findings as well as capture the enthusiasm generated over a summit characterised by a sense of cooperation and social responsibility at this important juncture for the gaming and, more broadly, ebusiness economies. KPMG would like to thank the summit's sponsors, speakers and attendees and welcome you all to the KPMG eSummit series in 2016.

KPMG employs a number of eGaming industry specialists both in Gibraltar and globally and is committed to cutting through the complexity of this constantly evolving industry.

KPMG
cutting through complexity

Conference Opening

The Hon. Albert Isola

Minister

Gibraltar Government

The Hon Albert Isola

"Gibraltar is totally committed to transparency and exchange of information. There isn't one accord, one agreement, one convention, in relation to these areas that we're not fully subscribed to."

A third generation member of the family-owned law firm Isolas, which has been doing business in Gibraltar since 1892, the Hon. Albert Isola was admitted to the Bar in England and Gibraltar in 1985 and was appointed as the Gibraltar Government's Minister for Finance and Gaming in July 2013. Since then, Mr Isola has overseen the continued expansion of Gibraltar's eGaming community to now accommodate over 3,000 employees as well as 28 licensees, and has been instrumental in securing the jurisdiction's reputation as a global centre for eGaming.

"I think I'd like to start by saying one thing about Gibraltar PLC and its outlook in terms of business," Minister Isola introduced KPMG's fifth eSummit in Gibraltar. "And I think I'd like to stress how important it is to us that the journey we've embarked on is a total commitment to compliance. Gibraltar is totally committed to transparency and exchange of information. There isn't one accord, one agreement, one convention, in relation to these areas that we're not fully subscribed to, so when we talk about FATCA, and the Common Reporting Standard, Gibraltar was one of the early adopters and totally committed to that area of compliance."

Minister Isola continued by emphasising his pleasure in confirming that Gibraltar is subscribed to 130 exchange of information agreements, as well as all appropriate directives. He emphasised the importance of being a part of Europe and of the importance of remaining proactive in the international regulatory debate. "Being a part of Europe is important to us, and of course it's also important to us that we comply. There isn't a single EU directive which we're required to transpose which we haven't. Those are obligations which we take seriously and you should know that when you come to Gibraltar you are coming to a totally EU compliant onshore jurisdiction."

"As many of you will know, for over twenty years we've had a very simple philosophy: quality operators, robust and sensible and proportionate regulation, and a real presence. Those principles have guided us successfully for many years to where we are today. Of course, it's also designed to protect, preserve and indeed enhance our reputation as what we consider to be the online gaming jurisdiction in the world."

Minister Isola confirmed that Gibraltar's eGaming sector currently constitutes over 3,000 employees and 34 licensees; an increase of 8 licensees since the 2014 KPMG eGaming Summit. He reminded the audience that a large number of these licensees, 8 or 9, were involved in acts of consolidation, meaning these licence numbers may not remain, but company presence will. "And this, despite the many challenges we've faced over the years; PoC tax, jurisdictions introducing their own regulatory regimes and, of course, the world economic crisis. Today, we are 100% bigger than we were five years ago. That's staggering considering the challenges you've all faced. And, of course, for us as a jurisdiction the icing on the cake is that the main operators in the sector are all here and represented in Gibraltar."

"So I think it's an example of how government and the gaming sector, and more broadly the private sector, can work together to battle through tough times, to meet challenges and to face them together. Consider what we now have - a collection of skills, nationalities, languages, experience, expertise, in a very exclusive sector – and all within two square miles. But, of course, that really isn't the end of the story; if we want to keep that, and grow that, and if we want to get better at what we do, it's important that we continue to focus, we continue to look forward and we continue to work together to find the solutions that will put us in a better place in five, ten, fifteen years' time. What we're talking about really is a centre of excellence: Gibraltar as a centre of excellence for the gaming community. That's where we as a government will focus our energies in looking at the gaming sector. Above all else, it's our intention to do it holding your hands and doing it together every step of the way."

The strength of its regulation and, indeed, regulatory team remains absolutely fundamental to Gibraltar's eGaming proposition and it was with delight that Minister Isola confirmed that Phill Brear will remain Gambling Commissioner for a further two years. During this period, Mr Brear will implement a full succession plan to ensure that licensees continue to enjoy the benefit of his advice and expertise. "A formal handover will also be created", Minister Isola confirmed, because we recognise that consistency in our regulatory environment is crucial to all of your businesses."

"A second area is virtual currencies. For the past six to eight months, the Gibraltar Government has been engaged with a working group and consulting widely, across all sectors, to see whether or not we should be introducing the virtual currency space into Gibraltar and, if so, how we should regulate it and impose the safeguards that we require in any business. We are at the stage today where the working group has completed its work, has provided its report to government and I am working on a cabinet paper to lead to a final determination on where we will go. I expect that will lead to further opportunities if it goes the way I think it will, but always against the context of the need to ensure that whatever we do protects the jurisdiction from adverse risk."

"Responsible gaming has been a priority from our very beginning. Gilbert Licudi is driving the Gibraltar University, which opens its doors in September 2015, and we have identified gaming as an industry in which the university has a role to play. We want to bring together gaming and students and see how, together with the many companies here today, we can work to put Gibraltar at the forefront of responsible gaming."

"Finally, a total review of our gaming legislation. It has worked, but it has worked in different sorts of ways. What we are doing now, and have done thus far, has been to instruct what I consider to be the four leading lights in the gaming community to work in the interests of Gibraltar PLC and improve the way in which we regulate gaming in Gibraltar. I don't think there's a better jurisdictional reflection of excellence than this group of individuals and their bid to ensure that Gibraltar's legislation is fit for purpose, proportionate and robust. With our recommendations in place, I hope to be able to consult with you collectively and individually. I do intend to communicate with you all to make sure you understand what we're doing, why we're doing it and what your thoughts are. It is very much a total consensus approach. My door is always open and you have the Gibraltar Government's full support. Thank you, and enjoy the rest of the day."

"It is very much a total consensus approach. My door is always open and you have the Gibraltar Government's full support."

KPMG
cutting through complexity

Panellists
Peter Howitt, Founder and Director, Ramparts
Sir Peter Caruana, KCMG, QC
Peter Montegriffo QC, Partner, Hassans,
Steven Caetano, Partner, Isolas

Panel Session: The Review of Gambling Regulation in Gibraltar Update

Phill Brear was appointed as Head of Gambling Regulation for Gibraltar in October 2007 following two years as Director of Operations with the British Gambling Commission. In July 2011, he was appointed as Gibraltar's Gambling Commissioner in addition to his existing responsibilities. Having played a leading part in the roll-out of the UK Gambling Act and gained experience across the breadth of the British gambling industry, the switch to Gibraltar, 'home to the world's leading online gambling operators', brought a new set of challenges, with Gibraltar's adoption of its new Gambling Act. Since his appointment Phill has steered through a series of changes to the regulatory regime whilst working closely with operators and their representatives on a wide range of operational and organisational issues. Phill is also responsible for liaising with bodies as challenging as US regulators and the European Commission.

"We have here the founders of the remote gaming industry in Gibraltar", Mr Brear introduced an overview of the initiation of Gibraltar's review of its gambling legislation, and licensing and regulatory model. "There isn't an online operator in Europe and, possibly, the world who doesn't know of these individuals and hasn't used their resources to navigate the complex world of online gaming in the past. It's an amazing team we have here."

Mr Brear continued in clarifying Gibraltar's goals as it embarks upon a review of its gambling licensing and regulatory regime. He emphasised that whilst there is a collective drive to move forward with revisions, continuity and the future-proofing of Gibraltar's proposition remain of paramount concern. "This is not about starting again, it's about building upon what works", Mr Brear maintained, "and if something is broken, we will fix it." He then turned to Sir Peter in asking the first of the day's panel questions.

How did we arrive at this point, and what are the drivers for change in Gibraltar?

Sir Peter Caruana: "The story of Gibraltar's involvement in this exciting industry is, I think, relatively well known by most", Sir Peter began. "Its success can be attributed in the first instance to just a few words: a commitment from the very outset, and from successive governments of Gibraltar, to excellence. We did not want to be all things to all men, and we knew that protecting our reputation meant limiting the people we let in as operators to those who shared the same concern for their corporate reputations as we do for our jurisdictional reputation."

Sir Peter explained that this approach quickly led to a policy decision for what has become known as 'selective licensing', whereby Gibraltar eschews volume in favour of quality. Of the hundreds of licensing applications submitted, only a handful of applicants have been granted presence in Gibraltar, becoming stakeholders alongside the government and the rest of the domestic industry, all of which fosters a common vision.

Peter Howitt | Sir Peter Caruana | Peter Montegriffo | Steven Caetano

Moderator: **Phill Brear**
Gibraltar Government

"Successive governments have supported, but more importantly, understood this industry."

This selective approach to licensing, Sir Peter continued, allowed for a lighter regulatory touch coupled with a sense of self regulation, which was deemed affordable in terms of safety because Gibraltar had been selective and restrictive in the first instance. Indeed, this policy became attractive to large operators who identified Gibraltar as a jurisdiction whose vision and regulatory objectives they shared.

"So there was a constant assessment of the balance between a sufficient measure of regulation to protect the jurisdiction and consumers, and at the same time having an equal degree of sensitivity for the needs of an industry which we knew was nascent and which was and still is in a constant state of evolution", Sir Peter recalled. "It was important that we weren't too rigid in our policies. Whilst we had certain core elements that were designed to make sure that Gibraltar was a brick and mortar, and not a brass plate jurisdiction, and that we had sufficient oversight and handle on our operators; we couldn't be so rigid that we prevented companies from developing. We coupled this with an emphasis on quality of life: issues such as safety, education, travel, an open labour market, and a very supportive community. These issues may not seem so but they are also crucial to our proposition."

"So, to summarise; successive governments have supported, but more importantly, understood this industry. As a result they have been able to make administrative, encourage regulatory, and also made legislative decisions which have been propitious for the safe development of this jurisdiction as one of the foremost for online gaming."

Mr Brear agreed, adding that there is a common understanding that the infrastructure of the industry is changing with its growth and multiplication, "so the entry points into licensing need to be revised. This control and definition of who should and may be licensed is a launch pad of the regulatory model." Turning to Peter Montegriffo, who is credited with coordinating Gibraltar's historical approach and modernising its regulatory regime, Mr Brear then asked: **could you elaborate on any developments?**

Peter Montegriffo: The 2005 Gambling Act, which currently regulates gaming in Gibraltar, was conceived at a time when internet gaming was very different, Mr Montegriffo pointed out. "Back in 2005 the EU debate on a cross-border, liberalised market was very alive, the technology was very different in terms of delivery and the controls required. The role of hubs like Gibraltar was also very different. The 2005 Act was struck correctly at the time both because it reflected that environment and it was designed to provide latitude and flexibility for this industry as we knew it would evolve."

"This now needs to be looked at because the world and the landscape have moved considerably. Of course, Gibraltar has adapted to the new businesses within the parameters of the Act successfully, but it has had to stretch some of the concepts. For example, we license B2B operations in Gibraltar though our legislation was more properly conceived for B2Cs. So, there's a need to look at the criteria for licensing in terms of what triggers the requirement for a licence, such as a piece of remote gambling equipment in Gibraltar, and we need to evaluate what is currently a single form of remote gambling licence."

Mr Montegriffo elaborated, adding that many other 'hub' jurisdictions utilise a range of licences which might include B2B, disaster recovery, and other peripheral activities which are then connected to the mainstream gaming activities which are regulated. "These jurisdictions have sought to create space more specifically for the different elements of the gaming industry as it diversifies and becomes more complex. In revising our frameworks, we're interested in accommodating that same reality and enabling ourselves to police the perimeter; that is to say police those companies outside of Gibraltar but which nevertheless seek to establish some sort of link to the jurisdiction, potentially raising reputational issues. So what we're looking at is how to redefine the boundaries of our licensing, so that we may better police those that lie outside of the boundaries."

Mr Montegriffo then reiterated the fact that Gibraltar's basic approach and its very selective requirements for entrance – the need for substance, accountability and presence in Gibraltar – are unlikely to change. He stated that the review is therefore very much one of "modernising, revamping, empowering and making more relevant the business that we have here, and building a platform for its continued expansion."

How might we define what lies beyond the boundary of Gibraltar's regulatory reach?

Steven Caetano: "We looked at the commercial rationale for potentially regulating the unregulated or non-traditional gambling products which are out there, and we looked at the existing legal regime here, and we saw that the legislative framework is wide and robust

KPMG
cutting through complexity

enough as it is," said Mr Caetano, who kindly stood in for the programme's original speaker Peter Isola. "We could regulate something like social gaming, for example, with small extensions to the existing framework. Then we looked at the arguments for and against regulating something like social gaming. We found an equality of arguments and that, ultimately, it was the practicalities of enforcing regulation that would inform our decision to regulate and whether that's more appropriate matter for consumer regulation. What we've done is set out the new potential developments in the industry that currently lie outside of Gibraltar's regulatory boundaries, the advent of cryptocurrency for example, and we will monitor these developments in order to be the first to embrace and regulate accordingly if we deem it appropriate."

Is there a synergy or not between e-commerce, e-currencies and eGaming?

Peter Howitt: Notable for his expertise on the convergence of and overlaps between eGaming and financial services, Mr Howitt explained that one of his areas of activity as part of Gibraltar's review was looking at the potential to 'borrow' principles based financial services regulation for application within eGaming. "From a wider perspective, however, it is interesting to first look at the history of gambling, particularly outside of the UK and on the Continent," he noted. "Gambling is coming from a place quite different from banking and other financial services but it does seem we're moving in the same direction in terms of concepts relating to the protection of consumers, treatment of funds, treating customers fairly, etcetera. It is also clear that there are shared areas of sensitivity relating to operators and the management of public policy issues. It is interesting that online gambling is starting to be seen in the same way as financial services, and that presents opportunities and some risks."

One such example, Mr Howitt went on, was the forthcoming 4th European Money Laundering Directive (4MLD) which, although previously identified as a threat, may also present an opportunity for eGaming. "The 4MLD represents a coming of age for online gambling which can now be talked about in the same breath as financial services. It's also an opportunity to gain some of the benefits enjoyed by financial services such as doing business across borders."

Looking at the current legislative framework in Gibraltar, Mr Howitt explained that the jurisdiction has the 2005 Act, bi-lateral private contacts between the government, operators and licensing authority, and codes of practice. He emphasised that commercially and reputationally Gibraltar has enjoyed great success, but that the current process of appraisal allows Gibraltar to look at how best to showcase these strengths and demonstrate how it meets its objectives. "The focus for me in the process of this review is to make sure we really highlight what Gibraltar is very good at and use it as a chance to make explicit what Gibraltar does well every day. One of the things I personally like in terms of the way Gibraltar does business and regulates gambling is that ours is a very human led form of regulation, and we don't want to lose sight of that in this review. In some jurisdictions there are copious amounts of documentation, but limited interaction with operators and it's difficult to see that as the best form of regulation. In this review, we have to make sure that we look at the structure of the Act and the licence agreements and move to a more principles based approach where the regulating authority sets out their stall, identifies their objectives and what their role is as a stakeholder. It then needs to give the operators conditions for licensing which make it clear that there are certain things that they must do which aren't necessarily specified in particular parts of legislation, but which are fundamental to the proper functioning of a gambling market that protects consumers and protects stakeholders. We want to make changes that really put Gibraltar at the forefront of any regulatory regime in the world."

Phill Brear: "There are, basically, two models of licensing out there. One model is high entry point, limited numbers, which we see a number of jurisdictions effectively adopting. Then there's a different model of large numbers, possibly low entry point. Here, it's quite clear that there is a commitment to continue on the same path of a small number of locally licensed, locally established and locally regulated operators, even with a broader base. Could we discuss this?

Sir Peter: Sir Peter confirmed that there is consensus that Gibraltar will adhere to its model of restrictive, as opposed to open, numbers based licensing. He reiterated Mr Montegriffo's earlier point, however, that the threats and challenges come not only from the difficulties in regulating effectively those high numbers of operators, but also from the difficulties involved in regulating the now greater number of licensees that are not themselves operators, but which provide services to operators which blur the lines in the minds of the consumer. "In terms of the regulatory objective, which is consumer protection and the protection of the jurisdiction's reputation, these are capable of causing as much damage as if there was a problem with a gaming operator. We must ask to what extent international public opinion is going to distinguish between Gibraltar's link to an operator, Gibraltar's link to an affiliate or marketer, and Gibraltar's link to a registration processor, for example."

Sir Peter noted that the review committee was considering the establishment of a licence separate to an operator's licence which would license a whole series of support services activities to gambling operators which themselves might challenge the regulatory objective.

Peter Montegriffo: Mr Montegriffo agreed, adding that this situation also represents an opportunity in as much as Gibraltar's reputation has attracted to Gibraltar's shores a large number of highly skilled individuals, many of whom then find it attractive to do business beyond the gaming space. Some, however, have found in the past that Gibraltar's current licensing and regulatory environment is not conducive to these activities. This review, therefore, represents an opportunity to embrace these ideas and allow individuals to do business as they wish in a licensed and well regulated manner.

How do we intend to bring the regulatory toolbox up to date? How and when might those tools be used?

Sir Peter: "This refers, again, to balance," Sir Peter confirmed. "The theme of our work has always been an attempt to achieve equilibrium between the commercial needs of the industry and

"Ours is a very human led form of regulation, and we don't want to lose sight of that in this review"

protecting regulatory objectives. This discussion is about the second of those two, but will always take place against the context of a balancing act. The 2005 Act, read together with and implemented side by side with the licence agreements, have to some standards provided a light touch, but nevertheless have also provided a completely effective form of regulation in the context of the limited numbers that we were admitting."

"But the world is changing," Sir Peter continued. "The industry is becoming much more multi-jurisdictional, multi-licence. In a sense, there are more regulators, licensing authorities and foreign authorities looking at each-other and expecting to find something in companies' interactions with their own territories. That view, really, is the driver for the review of regulatory enforcement and regulator powers aspects of this exercise. The 2005 Act and our licensing agreements gave us the first mover advantage. We're determined that in the regulatory space, too, we will keep that prominent position and not allow it to be degraded by the view that our current regulation has no longer kept pace with the changes happening in the world at large. A lot of the changes we're thinking of are there to make the system fairer, more balanced and more transparent for the benefit of the operator with a more incremental range of options for regulatory intervention. This will enable the regulator to access information and assess financial status, thereby better arming him to identify in advance and avoid problems, and allow for more measured, proportionate and effective terms of intervention."

What is the right mechanism to move us to where we need to be with regard to regulatory powers?

Peter Howitt: "The 2005 Act was enabling legislation, and the switch now is to create an enabling regulatory framework," explained Mr Howitt. "We need to put more of the heavy lifting with the legislation, but in a more transparent way so that the world can see how Gibraltar does business, and how it looks after stakeholders and consumers." Mr Howitt explained the intention is to make explicit the regulating authority's role in achieving certain goals, whilst also making explicit, on a principles basis, the corresponding role of the licensee, thereby creating a dovetailed, collaborative relationship of common objectives.

Could we reflect on the efficacy of the consultation process?

Steven Caetano: "We must ensure that our door remains open if we're to respond to an unpredictable and ever-changing industry. We're trying to create as future-proof a piece of regulation as we can. With a principles based approach, there's leeway which enables us to adapt as the industry moves forward."

Mr Caetano confirmed that, in terms of timing, the paper will be presented to the government before its summer recess. The government will then consult with the industry, a measure deemed absolutely imperative, with the results of the consultation ready by the end of 2015.

Peter Montegriffo: Mr Montegriffo agreed, and expressed his desire to make absolutely clear that part of the exercise is also to codify what the regulating authority already does. "This is not just new thinking. When we talk about principles led regulation and so on, what we're talking about is codifying a way of doing things which has already proved successful in Gibraltar, but which will allow greater visibility as to how that model works. Effectively, we would envisage in due course that licensees would move away from the detailed agreements that currently exist because the requirements for those agreements would be contained in codes or in guidelines that would effectively apply across the board. So it's just a codifying of the existing practice and the existing contractual arrangements that all licensees sign up to on a pretty regular and standard basis."

Question from the floor: Will this be a very expensive exercise?

Sir Peter: "We and the government are acutely aware of that issue," Sir Peter assured the floor. "Part of the exercise we're undertaking when we mention our desire to ensure we remain relevant as a jurisdiction must include that we remain competitive. Of course, good things do come at a price and the Gibraltar proposition has always been that there is a deliverable, but we expect accountability, regulatory footprint, we need people on the ground, there are issues of technology, costs and duties as part of the review – that is all in the melting pot that we're sure the government will be discussing with the wider industry."

Peter Howitt: Mr Howitt added his opinion that the review is unlikely to have any significant cost implication for licensees. "Really, what we're doing here is trying to make sure that the jurisdiction and our operators continue to be seen as the best in the world. We're trying to give a framework that shows that to the world without unnecessary box ticking. We're all saying it, we can believe it, and the financial figures and economic impact speaks for itself."

KPMG
cutting through complexity

Blockchain 2.0

Preston Byrne

Co-founder & COO,
Eris Industries

Eris Industries is a blockchain technology start-up headquartered in London. The company has launched the first, and to date only, open-source smart contract developer platform to market. Preston is also a fellow of the Adam Smith Institute, where he advises on the intersection of law, economics and technology. Preston's work for the ASI encompasses a wide range of subjects including law, security policy, and capital markets. Before founding Eris he was a securitisation lawyer with Norton Rose Fulbright LLP in London.

"Bitcoin is confusing a concept that really isn't that confusing at all, it's just software."

The "blockchain" database used by Bitcoin is a technological marvel, but a commercial nightmare: unregulated, uncontrollable, and extremely punishing of mistakes. In this talk, Preston explains how improvements in blockchain tech now allow enterprise to cherry-pick the best parts for their own purposes while leaving the rest behind.

"By way of introduction; my name is Preston Byrne and I am the co-founder and COO of Eris Industries. What we do is take the blockchain and we make it usable in enterprise and other contexts", Mr Byrne began one of the eSummit's most intriguing coffee break presentations. "Today, we're going to be talking about exactly what it is and what it means, whilst hopefully clearing up some ambiguities. This is because Bitcoin is confusing a concept that really isn't that confusing at all."

"One thing I ask you all to keep in mind for the duration of this presentation is 'it's just software'. I ask this because a lot of people have been talking for years about the blockchain and its use for things like land registration, key management, identity records, this and that. But, everybody is only actually using one blockchain, which is Bitcoin – the unregulated transfer mechanism. Eris Industries thought 'why don't we build something that people can actually use?', so that's what we did."

"We did this because if you look at Bitcoin not as a currency, not as a commodity and not as a value storage mechanism, but as a piece of software; it becomes simply a distributed clearing and settlements system. If you submit a transaction into that clearing and settlements system there is no clearing, it settles in between five seconds and six minutes and is also confirmed within that time. This is because of the cryptographic architecture that is utilised. We looked at that and realised that this was 99.98%, roughly two orders of magnitude, faster as against the T+3 cash settlements system [T+3 translates to 'trade date plus three days'; the deadline for securities certificates to be issued to settle a securities transaction]. What this means is the blockchain is a process automisation, or process efficiency, tool which everybody has confused for a monetary transfer system."

Mr Byrne explained that most people view the blockchain as a monolith; a big, globally distributed, resilient, highly powerful and indelible system which serves a single purpose: "and we're all supposed to bow down and pretend it's the best thing since sliced bread". Eris Industries, however, acts on the view that the blockchain is in fact an open source means of creating countless variables on the blockchain database model, each of which is able to serve a different function and can be repeated in context. "Very much like an assembly line; the difference between our approach and the current approach is that if it's a repeatable piece of data infrastructure that's very cheap, you can start putting data to work for you, instead of you having to work to manage it", he added.

"And we've made it commercially relevant. The problem with Bitcoin is it's uncontrollable; all of your users are unidentifiable, the value of the tokens itself, which is really just data, is extremely volatile. This is not something you get when you work within a normal database and in a corporate, or any other kind of context you need absolute control over what that system is going to do."

"So, what we've done is said 'right; what are the things that corporate, developers and governments need?'. First they need accountability; they need someone in charge in case something goes wrong. They need controllability; they need to be able to step in, tailor that system and tell it to do anything. They need repeatability; they need to be able to repeat a process with absolutely no additional infrastructure. And they need reversibility; not in the sense of going back and pulling things out of the blockchain – which you can't do, that's the first law of the blockchain – but telling all the users of that system that, if a particular transaction is fraudulent or needs to be reversed, they need to ignore it. That's what we did."

"What this means is the blockchain isn't magical and it isn't a money machine. It is a database, it is just software. As a result, it will do exactly what you tell it to do; no more, no less and with a very high degree of exactitude. So, as a consequence, it's now possible to use blockchains in very specific contexts to realise process efficiencies in organisations without needing a cryptocurrency in order to do so."

"To understand what this means, it's worth understanding, quickly, the way in which the Internet currently works against the distributed Internet", Mr Byrne explained. "At the moment, every action a user takes is controlled from somewhere else and on a machine. A user inputs information on a web browser while everything else is produced by a far away server cluster. By logging into Facebook in Europe, a user is 'talking' to servers in Ireland. Even a message sent to a friend is done so via those servers. At no point are two users communicating directly, or peer-to-peer."

"This isn't cryptocurrency; it's software development"

"In a peer-to-peer framework, by contrast, the machine in the middle is taken out and everybody starts communicating with each other", Mr Byrne continued. "The benefit of that is that if you're using peer-to-peer computing we now have more processing power and hard-drive space than we know what to do with. Most of us have more processing power in our pocket than the entire world had in 1990. So, we try to come up with frameworks where people actually use that instead of lying fallow for most of the time."

Mr Byrne described blockchains as "a pretty interesting peer-to-peer infrastructure". A blockchain is two things, he explained, a database, or the transaction history of a group of users using that particular blockchain. In addition, a blockchain is also a protocol, or a series of rules which govern how that database functions. Another type of protocol, HTTP or Hyper-text Transfer Protocol, governs use of the World Wide Web, "but we don't put all of our data for all of our websites on one server. Instead, we spread it out and agree the rules by which those databases are built to interact with one another. A blockchain is very much the same."

"Bitcoin is a database and a protocol. On the client side, there is an implementation to that protocol; a programme which reads that protocol and displays it on the user's machine through the programme. A better way of looking at it is a blockchain is a distributed rulebook which has a transaction history and which tracks and secures the process of changing and updating that transaction history. Any write permissions to that database, say spending a Bitcoin, on any other database, say a blockchain based social network, are secured by the use of public key cryptography."

"This means that if you know the rules – if you download the blockchain – you can know them and you can know everyone who uses it, and you can know everyone's public keys. But, if you don't have the right key, you can't interact with this database in a way that you're not allowed to. In addition to that, you can't change the database even if you're in possession of it. This is phenomenal. It's like saying, 'here's a copy of the Companies Act but you can't change it just because you scratch out a bit on your copy'. So, it's a very resilient framework for data-driven transactions instead of cryptocurrency."

"So, what are the primary rules we have to keep in mind when we consider what the blockchain is going to do in the future? There are three of them, and you may have heard these before: 1. Tell 'em what you're gonna say. 2. Say it. 3. Tell 'em what you said."

Mr Byrne explained that the first rule, 'tell 'em what you're gonna say', is known as the transaction protocol. Effectively, these are the rules that apply to the user. They dictate the purpose of the blockchain, what people do when communicating, who can broadcast transactions, their permissions when they do so and how they do so.

Rule two, 'say it', describes the networking protocol, which determines how users communicate with one another. It dictates what can be said, to whom it can be said and in addition, how a user interprets what other people say to her. "What the blockchain does is ensure that every transaction, every node, every computer using the system processes every transaction sent on

"The blockchain is a process automisation, or process efficiency, tool which everybody has confused for a monetary transfer system."

the system. Everyone agrees the state of all of the data in the entire world on an ongoing basis. With Bitcoin this is every six minutes and if someone if Japan sends some Bitcoin to someone in South Africa, I can see that from the United States. But, knowing that does not allow me to interfere with it."

"Finally, there's 'tell 'em what you said' which in my view is the most important principle. We call this the consensus protocol. This confirms what has been said, who said it, and whether the record is correct. The latter is most important because the thing about Bitcoin is what happens in the past determines what can happen in the future. If I've spent all my Bitcoins I can't do it again. If I try to do it again, the system will reject it. For a corporate this is interesting because you don't need to supervise the system. You know that when a user finally disperses all of their funds from an account they're not going to be able to double spend. So, you're putting the transaction history to work for you by creating a predictable framework where the data is actually regulating itself. You take all these rules, put them into a rulebook and translate that rulebook into something we can understand, like a Bitcoin wallet."

"The reason people think Bitcoin and the others are so special, if we look at it in this three rule framework, is that it's first open to all and evades government controls. Secondly, it is resilient to interference and destruction because it's spread around the world and, thirdly, it relies on competitive mining, which means you have to throw a lot of computer power in order to get a new block of transactions in the chain – but you don't have to."

"Bitcoin doesn't solve any particular problem very well. However, if you look at the blockchain as a data structure that can do anything you tell it to do; you can engineer very specific solutions to very specific problems. This means you can cherry pick the things you like about Bitcoin while leaving behind the things you don't. That mostly means assuming control over the database, allowing for a new attack vector (in from the top), but it also means that you don't have to supervise what your users are doing with it and you don't have to manage the data quite so much."

"The question is, of course, why do you care? Well, for a lot of things you probably don't, to be brutally honest. Anything a blockchain can do, a server can do. If you're perfectly happy with the things your servers do, then keep on doing it. If, however, you have some coordination or security problems which you think a blockchain might be able to solve, then that's something you might want to consider. So, if you're coordinating multiple software stacks, acquiring other organisations and translating data into a uniform framework for global reporting, you might want to use the blockchain. If you want to simplify multiple processes into a single process, or want to get human beings out of the equation, this is something you want a blockchain for. If timely verification is paramount, a blockchain can be programmed to verify very, very quickly as against a human verified process. And if you want to reduce your supervision or oversight costs it's also very useful."

"But, what are the things that blockchains are bad at? Well, if it requires speed – if the speed of light is your enemy, like in high frequency trading – the answer is a very firm no. This is not something to get information out quickly; it's to try to get it out verifiably. If it requires very heavy computation then no; blockchains are passive, they are permissions and authentications databases. They control what people do and the relationships between people; they are not designed to pipe information out to them. They constrain them, and in a very transparent way. And for things that are automatic anyway, a payments system for example, then the answer is, again, no. I get a lot of flak for this opinion, but I don't think the blockchain is good for payments. Payments systems are very low latency, very high volume, and they're almost entirely automatic. Charge backs are one piece of the equation, but seven transactions per second means it's not very good as a global payments or settlements system. You can, however, drop in a blockchain to confirm the transactions are accurate."

"So, we know how a cryptocurrency works, what about any other kind of blockchain? Well, we can change that as well, just by going back and swapping the rules. If you have a corporate chain, you might say it must be controllable in every respect. All write permissions must be accessible through public private key encryption and cannot be open to the public and you can have an administrator key to change permissions on command. You also want to distribute the logic so that the system can't be flooded with packets, attacked or destroyed. Finally, you might want to change any aspect of the system on command, but the way you do it must be very transparent because you can't take data out of the past or change it. This meets all commercial standards of data security and certainty. Finally, no mining. Mining is an incentivisation model or feature of the database, it is no longer necessary."

"Once you've designed your system, you come to Eris Industries, write your rulebook, roll out the chain and deploy your decentralised app. Once you've done that, you do it again, and again and again, because this isn't cryptocurrency; it's software development. Blockchains are not money machines; they're just databases which can do some really interesting stuff. Now you can create as many as you want and you don't have to pay anyone a penny to do so."

Panellists

Kriya Patel, Managing Director, The Bancorp

Tony Craddock, Director General, Emerging Payments Association

Tom Cregan, Chief Executive, Emerchants

Miles Paschini, Group President, Wave Crest Group

Panel Session: Emerging Payments

Moderated by:

Andrew Johnstone,

Director Prepaid Business Development, MasterCard

Andrew Johnstone

Andrew Johnstone has been with MasterCard for 7-years and is currently Director, Prepaid Relationship Management and Business Development in the UK & Ireland, working across the value chain with distributors, programme managers, processors, issuers and consultants.

Andrew started his career at HFC Bank in 1995 and held a number of sales, marketing & database marketing management roles. Andrew then took responsibility for European consumer finance marketing in HSBC's European operations, developing marketing strategy and leading teams in 5 emerging markets, covering 6 business channels as well as providing consumer finance consultancy in other global markets. After HSBC, Andrew spent a year at a venture-capital funded start-up lending company, supporting and developing the UK network roll-out, marketing strategy and communications. Andrew has over 20-years' financial services experience and a geography degree from Royal Holloway, University of London.

"With the new SEPA [Single Euro Payments Area: an initiative promoted by the European Payments Council to create a single common cross-border payments system] regulations coming into play, Gibraltar and the UK's issuers are increasingly operating across Europe with the result that the two jurisdictions are quickly becoming regarded as centres of excellence for prepaid and emerging payments", Mr Johnstone began. "What we have here are representatives from the cutting edge of emerging payments and of some of the fastest growing and most innovative organisations in the market. But first, I must ask:

In your view, what is an emerging payment and when is it considered emerged?"

Tony Craddock: "The difficulty with this term 'emerging payments' is that, to some extent, it is boundless. Essentially, however, I think it has four angles to it. There's the angle of technology; such as the digital and virtual execution of payments. Then there's channels, such as mobile, online, peer-to-peer and possibly in-store or face-to-face in terms of value exchange. The third angle, meanwhile, is emerging processes, or emerging ways of doing things. One of the things our trade body, the Emerging Payments Association, does, for example, is it looks at the way in which the infrastructure of payments is enabling us to do things efficiently and well. The fourth and final is emerging markets, which isn't necessarily restricted to geographical terms but also entails verticals. This is why gaming is such an important area for us. It is absolutely an area where emerging payments are being deployed brilliantly. It could also be transit; for example Uber is not a taxi firm, it's a mobile payment firm with a little geo-location tech on top of it. Emerging payments have applications anywhere. A seed of an idea can grow to become a flower or a redwood tree. I think it's considered to be 'emerged' rather than 'emerging' when it becomes boring."

Would you say pre-paid is 'emerging' still?

Tony Craddock: Mr Craddock explained that pre-paid gift vouchers could rightly be considered emerged, whereas a number of pre-paid eWallets are still in the process of establishing themselves in the market. "So prepaid is still firmly in the

KPMG
cutting through complexity

"Uber is not a taxi firm, it's a mobile payment firm."

emerging payments area. It has been so, to some extent, for the past 20 years."

Kriya Patel: "To put that into context", Mr Patel added, "as part of the wider group, The Bancorp issued over 70 million cards last year in the US alone, the majority of which were prepaid, with some debit. That doesn't necessarily mean, however, that prepaid is emerged. Just because something is established, doesn't mean you cannot evolve that system to work in different ways. There's always a need to find new ways of doing things, but utilising tried and tested infrastructures."

Miles Paschini: "I take a slightly different view of it. I think prepaid is just an extension of credit and debit, and if you look at the volume of prepaid in dollar volume around the world it certainly, in my view, has emerged. I think the exciting thing in prepaid at the moment is application. Certainly in the early days prepaid meant a gift card but we're now seeing applications that people don't even realise." Mr Paschini used the example of airline ticket purchasing on an aggregator website, explaining that the aggregator is likely using prepaid systems as a means of settling payments with the airline. "These are emerging uses for an emerged technology."

Tom Cregan: "We have a term in our company which we call a 'legitimacy gap' when we look at different emerging payment types", Mr Cregan added. "In the US pre-paid is now commonplace, but in Australia we're talking to customers who really have had very little exposure to it and therefore see it as somewhat illegitimate. It takes time and energy, and a lot of hard work, to propagate programmes in the market. The more programmes, the more people become familiar with it, the less illegitimate it seems. Crypto-currencies are facing the same thing today, but over time it will become legitimate. So, I think a payment system becomes emerged when the customer on the street understands what it is. When there's no legitimacy gap, you can consider it to have emerged."

What do you think is stopping traditional players embracing emerging payments?

Tom Cregan: "I think there's a whole raft of factors affecting their decision", Mr Cregan offered, "traditional thinking, risk aversion, established business models. I also think they're not by nature innovative companies. The companies that invented prepaid, for example, were not banks; they were entrepreneurial outfits risking their own capital. Only when they had built great businesses did the banks enter the space and work with them."

Tony Craddock: Mr Craddock agreed, adding his opinion that the situation is a little difficult. "An elephant is an elephant, it has no choice. The smart elephants are the ones who understand that rather than trying to innovate themselves, it's better to support other, more agile organisations. MasterCard, for example, supports the Emerging Payments Association's incubator for early stage payments companies in London. This incubator works as a catalyst, so that's what we've called it –the Catalyst. MasterCard acts as a Benefactor of the Catalyst and supports companies trying to innovate."

"In fact, I'm delighted to announce that, as of today, The Bancorp is also going to be a benefactor of the Catalyst. It's important to take inspiration from the entrepreneurial, smaller companies which are more risk friendly, maybe are in touch with the vertical they're working in and want to get access to the best of breed in payments. For the

"The idea of moving money around the world in milliseconds exists, the technology is there."


Kriya Patel

big companies it's difficult, but that's not to say they can't contribute like MasterCard and The Bancorp."

Miles Paschini: Mr Paschini added his opinion that there are two barriers to innovation that companies need to embrace. The first, he explained, is that many companies are unaware of the options available to them today and which could improve their business. Brand and reputation also play a critical role. Drawing upon Bitcoin as an example, Mr Paschini submitted that many understand its benefits but that a lack of understanding of risk and perception means they're reluctant to engage with the technology.

Kriya Patel: "There are banks, building societies and other financial institutions that could take this step, but I think where they struggle, historically, is in education and the fact that they will take so much longer to make those decisions," Mr Patel added. "As a result, we as an industry have taken ownership of innovation. We facilitate solutions for people who are innovating and finding new ways to manage payments. We have the opportunity to be responsive, more agile. But the focus is still the same, we're a risk based organisation; we balance the opportunity against the risk associated with taking something new to market, whether that's reputational risk or financial. But for a proof of concept to be a success, it needs somebody to support it."

He continued: "Often, the companies that come up with the greatest ideas for utilising traditional infrastructure based payments are really pushing the boundaries, but where they need support is from the guys who understand the regulation, the compliance, understand how to deal with payment network rules. That's the important part that we play. Industry bodies play an incredibly important part in the education piece, and we as an industry have to be a part of that."

Tony Craddock: "Absolutely", Mr Craddock agreed. "The regulator is always happy to promote responsible innovation, although this is one of the things that varies a lot according to where you are in the world. The regulator for payment systems in the UK is, I think, highly enlightened and progressive, and what they're promoting is innovation. If that's the case, we then come along to educate them."

What do you think is slowing the emergence of new payment types? What can be done to remove the barriers?

Tom Cregan: "Part of it is on the product level. I would love to claim this as original thought, but I recently learned that over the past 10-years the US has been home to over 400 emerging payment companies that have gone broke. They failed because unless these companies can become demonstrably superior, people won't change their habits because payments is a largely inert business and people will continue to do the same thing. They're not after incremental gain; they're looking for systemic gain. Once a company has created a demonstrably superior technology, however, the ones that are successful are those who then ask 'can it be scaled?' and marry it to a company which already has scale. A lot of emerging companies die because they don't have the right strategy."

Tony Craddock: "I also think a little bit of fear stops innovation. It's not a lack of creativity and there's no lack of technological solutions out there. It's really about the companies going out to the different verticals and saying 'we have some great solutions to solve your problems for you'."

Miles Paschini: Mr Paschini added that, from the perspective of Wave Crest Group, the greatest hindrance is varying regulation in different parts of the world. "We look at opportunities almost every day which are truly cross border. If we work in a regulated environment in the US and one in Europe, I can assure you they're not harmonised. This is a big barrier. The world is globalising; the idea of moving money around the world in milliseconds exists, the technology is there. The idea of a harmonious anti-money laundering, anti-fraud, know your customer environment does not. For us, this is a big barrier. You have to look at opportunities that only fit within the multiple regulatory environments that we work in."

Tony Craddock: "Unfortunately, I think that's a given", Mr Craddock added. "The Emerging Payments Association looked at what it would take to harmonise regulation, thinking that surely there is 'best practice' regulation out there. But there is a vested interest amongst the legislative and regulatory industry in maintaining the status quo. Just imagine if, rather than the 295 different jurisdictions, one for each country, we had one effective regulatory jurisdiction. How many lawyers would we need then? My point is, we have to work with this legal complexity. We do want to see something more harmonious across boundaries."

Do you think that commercial partners and their users actually trust emerging payments?

Kriya Patel: Mr Patel believed so, adding that ultimately the question goes back to why innovation exists within the space to begin with. "Innovation is driven by change; whether that's consumers looking for convenience, or companies for security. As Tony touched on earlier, everybody makes payments every day;

> "That's one of the things we love about the industry, it's never short of innovation."

you don't think about it, you just do it. That piece is the most important thing for businesses and partners; helping them to understand the efficiencies they can gain, the solutions we can support and helping them to understand that it's within a stable infrastructure and is compliant. Often a single solution can involve six or seven different products, but from a consumer point of view, it's one. That's why emerging payments are going to continue to grow and are ultimately driven by consumer demand. I've seen so many payments innovations in the past ten years driven by gaming alone."

Do emerging payments matter?

Miles Paschini: "We're solving problems for businesses and governments", Mr Paschini affirmed. "I think there's a definite need in corporations to increase efficiencies, lower costs, automate processes and emerging payments can certainly be applied to these areas. Really it's about solving problems. The buyers that we see today are people who are looking to do things better. If you're used to effecting a payment over three of four days, and I can use a method to effect the same in three seconds, that's a big improvement."

Tony Craddock: "I think it does matter, and I believe so because if you get to the point where you're delivering all the right technologies, through the right channels, in the right market places then ultimately you're reducing cost and taking time out, and adding in opportunity for both commerce and revenue. In a world with 7 billion people in it, of which a massive bulk are unbanked and under-banked but do have access to these technologies, then the more efficient we can be the more likely we are to go out and touch these people, and improve lives everywhere. And the ability of emerging payments to improve lives everywhere is why emerging payments matters."

How can we make the end customer more aware of the potential benefits?

Tom Cregan: Mr Cregan explained that from his company's own experiences in Australia of late, the problems that the gambling industry has been trying to solve are more related to revenue than cost. He explained that working with companies with scale – those that are highly profitable, well run and widely recognised – ensures that the consumer adoption curve of an emerging payment option is rapid. Mr Cregan added, however, that this must be within the context of a wider product promotion and that a payment tool is, by itself, unlikely to generate widespread consumer interest. Only by sharing space with product focused promotions is a payment tool likely to see increased and effective consumer adoption.

Miles Paschini: "I think a lot of it is knowing your audience", Mr Paschini added, "because the small, innovative payments companies cannot compete with Google and Apple – they have budgets beyond imagination. To give an example, Tom and I compete in the taxi driver payments space, and they have a problem. The fleet operator has a problem about how frequently they pay their drivers, who are often under-banked migrant workers. In this case, it is they who will come to us, and we will respond with a solution to their problem. We earn the trust of the end consumer because we take the time to work with them and fix their business' payments infrastructure with a niche product. We'll both solve a real problem for them by listening to them."

Are the distributors putting the appropriate budget behind these products?

Kriya Patel: "That's part of the decision making when we look at partnerships", said Mr Patel. "This is an investment – you can't do things for free. We're all in this as a business to make money, so the business plans have got to stack up, and that investment can be made in many different ways. To market a new product to a consumer is incredibly expensive – so what we try to do is talk to the businesses that have these customers. If you educate the businesses, they can take that downstream with their budgets. But it has to solve a problem."

"We've seen particular success stories through distribution in Europe and the US", he continued. "In Europe, we ran an incentive programme for Bridgestone Tires over 20 countries. Some of those countries were new to prepaid cards, but we thought 'OK, we have a really trusted, international brand here with physical locations, so the accessibility's there. They're also giving something back to the consumer and they're gaining experience with a payment product they've never had access to before'. That was interesting to me because Bridgestone had the distribution, they were prepared to put their marketing dollars behind that, and they were giving me the ability to get in to a market, educate and help users to adopt the product, then expand that by reaching businesses we know would benefit from solutions we can provide."

What are the next big opportunity markets?

Tony Craddock: "My understanding is that Asia is really exciting and Africa is really exciting. I don't think much creativity and innovation in application is coming from the developed world. I think a lot of the most useful ideas can be transposed from the developing world to the developed."

Tom Cregan: "In those markets that lack financial infrastructure, mobile payments have really taken on a different dynamic. MasterCard, for example, is running identity cards with payment capabilities for up to 40 million people, which is landscape changing. We're also seeing a lot of innovation in Asia. Some we know are never going to launch – like an RFID chip you can wear on your shirt. But nonetheless, that's one of the things we love about the industry, it's never short of innovation."

cutting through complexity

Panel Session: Social Responsibility in Gaming

Moderated by:

Peter Howitt, Founder/Director, Ramparts

Peter has worked for over 10 years in the e-commerce and financial services sectors as a lawyer and corporate advisor in England & Gibraltar, and he is dual-qualified in England & Gibraltar. Peter also has personal experience of establishing an online social network for artists. He is currently the CEO of the Gibraltar gaming industry association the Gibraltar Betting and Gaming Association (www.gbga.gi) and Secretary of the Gibraltar E-money Association (www.gema.gi).

Panellists:

Wanda Goldwag, Chair and Independent Standards Commissioner, Senet Group

Stephen Donoughue, Gambling Consultant, www.gamblingconsultant.co.uk Limited

Martina King, CEO, Featurespace

Gilbert Licudi QC, Minister for Education, Justice and International Exchange of Information, Gibraltar Government

"There are different definitions and applications of the concept of social responsibility", Mr Howitt introduced one of the eSummit's most anticipated presentations. "I've read that it's really about corporate citizenship, which is certainly not a bad place to start and leads to an interesting dynamic in a capitalist environment. In an economy with companies largely structured for the benefit of shareholders, where citizenship is not usually part of a gambling company's constitution, it's not normally part of their legal requirements to shareholders, and it's often not what they've been set up for;

Why should companies care about social responsibility?"

Gilbert Licudi QC: "It is true that companies can look at this in isolation; purely from the point of view of the company, purely in terms of what you offer the customers or making profits", Minister Licudi began. "But being in business is much more than that. I think everybody realises it's not just about looking at the bottom line. And everybody recognises that there is an element of social responsibility. It's not just for us as politicians to set the agenda for social responsibility. It's the industry itself that often takes the lead."

Minister Licudi referred to the early days of Gibraltar's gaming industry, which was unregulated at the time. As operators began to move to the jurisdiction, he explained, the move for regulation to ensure that certain standards of social responsibility were enacted which maintained Gibraltar's high reputation came from the industry. "It wasn't initiated by government, it wasn't initiated by politicians, it was the industry that recognised that this was something that needed to happen."

Following a push from the industry which set those standards, Gibraltar's Gambling Act was enacted and, subsequently, its regulator Phill Brear appointed. "I think we've moved on precisely because of that recognition that we're all on the same boat, we all want the same thing for Gibraltar. We want Gibraltar to be held in high esteem and we want Gibraltar to be recognised as a jurisdiction that people want to come to and engage with. That's good for business and the jurisdiction."

Wanda Goldwag: "Companies should care because we don't live in isolation; we don't live in a world where I can take money from you and perhaps people who are quite vulnerable without being held to account – that's why social responsibility matters", said Ms Goldwag. "It doesn't matter if it's the gambling industry or financial services, or clothing retail, we all these days are in a world in which something we do can be commented on Twitter,

> "It's not just for us as politicians to set the agenda for social responsibility. It's the industry itself that often takes the lead."

Peter Howitt

and suddenly one hundred million people know about it."

Ms Goldwag continued in explaining that as well as being the right thing to do, corporate social responsibility is today also a commercial imperative. "When we trade, when we act, when we do deals, we do so in a way that's completely transparent. We've moved from a world where people didn't know about disasters and irregularities to a world in which everybody knows really quickly. We're not in a Watergate world now; we don't need journalists to investigate. We're in a Twitter world where a disgruntled employee can go on social media and say 'this company is terrible, do not deal with them' and hundreds of thousands will respond. So, it's morally right, but also a financial necessity."

Do you think online industries have a particular problem because of their remote nature?

Steve Donoughue: "My view is the online industry suffers politically from the view that you're all 'evil scumbags'", Mr Donoughue warned. "They see you as not paying any tax and that you're picking the pockets of your customers. What social responsibility is about is whether you're a good guy or a bad guy. Social responsibility is looking after your stakeholders, not just your shareholders. Your stakeholders are your customers, your staff, the community you work in."

"You have politicians out there who know very little about your industry. But what they do is put you in the category of good or bad, very easily. At the moment, the gambling industry is very definitely in the bad guy category. By becoming good guys, you get thought of as such by politicians and they give you a fair hearing. What I say to people is look at Wonga. They've just published losses of £135 million. They basically got slapped by the government because the government said they're bad guys. They're bad guys because, as Wanda said, there was a whole social media campaign, which was led by MP Stella Creasy, and the public view went against them. When the public view is against you, it's very easy for politicians to slap you. This is what social responsibility means for your industry. It not only makes you decent people, it also means you won't get damaged, and there are a great many things out there that governments can do to damage you."

"You are very fortunate here in Gibraltar. I've been very surprised today at the amount of government support, the degree of engagement with the ministers and the ministers' pledges to consult with the industry. But that simply does not exist in governments like the UK's, and that's dangerous."

Wanda Goldwag: "It's not just to do with the letter of the law and how that influences perception. These are the same principles applied to any industry", Ms Goldwag added. "If someone says to you 'what's best practice in the music industry? What's best practice in the aviation industry?', I can tell you the answer to that. If someone in financial services asks 'what do you think about the Wonga model?' – the answer would be 'bloody hell, they're insane!'.

Ms Goldwag continued: "One of the problems in our industry is we reward our staff for a great marketing idea, thinking 'this is going to make us a lot of money'. What they don't seem to ask is 'what will be the consequences of that? What will other people think about that?'. One of the things about social responsibility is it's not about out there; it's also about what your own business does. When an idea pops up there ought to be a moment when someone who was not involved in that process says 'yes, that will generate some short term profits, but in the long term our company will be closed down'.

Steve Donoughue: Mr Donoughue referred to the example of Paddy Power's now infamous campaign

KPMG
cutting through complexity

> "Social responsibility is looking after your stakeholders, not just your shareholders. Your stakeholders are your customers, your staff, the community you work in."

which allowed the public to bet on the results of the Oscar Pistorius trial under the title 'money back if he walks': "What that did was send a ripple right through to Westminster", he remarked. "Most of the people who had never even heard of Paddy Power now think they're bad guys. There were questions in the House [of Commons] and it was all just for the want of a couple of extra quid through a marketing campaign. Their reputation has slumped, but it's not just Paddy Power's because these politicians don't know Paddy Power from William Hill; it's the whole industry. It's that short term goal which sometimes ruins reputations."

Martina King: "It's important to express that internal voice", Ms King added, drawing from her experience as Managing Director for Europe at Yahoo!. "Corporations and organisations can get on a roll and forget to stop and review. For example, the laws of pornography are very different in California compared to the UK, making advertised content very difficult to filter. The pressure groups attacked the internet and search engines as a whole, which of course didn't even know what sort of content they were hosting. As soon as that whole Pandora 's Box opened the internet did exactly the same as the gaming industry and worked to address it. The consumer was quite right, there was some distressing content being advertised out there, but the response was the search engines were only hosting it and didn't publish the content itself. As soon as they got into that semantic argument it got confused. The consumer saw one thing, while the companies whose brands were being associated with this advertised content put forward the commercial argument. They asked the question: 'if your source of revenue comes from advertisers, and your advertisers are publishing questionable content, what impact is that having on your business?'. The search engines ultimately had to go and proactively sort that problem out, because it was the right thing to do for the consumer and the business."

Gilbert Licudi: Picking up on the topic of reputation, Minister Licudi added that the issue is particularly pertinent to a jurisdiction such as Gibraltar. "We're a small jurisdiction. In a large jurisdiction, a large scandal will clearly cause some ripples. It will cause some problems for that company, but it's very difficult to see that the whole jurisdiction will be affected in a truly devastating way. The position in Gibraltar is very different. If we had a very big scandal with a domestic company, that would be very bad for the jurisdiction as a whole. That's why it's so important that we do things the way we do here. Mr Donoughue expressed his surprise about the way we consult the industry and operate here, but it has to be like that, it's always been like that. It's true of all our industries where we develop these social partnerships. The emphasis has to be on maintaining standards and a high reputation and we do that by becoming home to the best companies in the world, which adhere to the best standards in the world."

Has the industry done a good job in dealing with sensitivities around advertising?

Wanda Goldwag: "The short answer is no they haven't. As soon as companies were allowed to advertise they were like kids at Christmas. Marketing ideas need to have some longevity and I think what happened was a whole series of companies who hadn't been able to advertise on TV and didn't have experience were suddenly able to. The result, it has to be said, was that some of the adverts were unbelievably crude, unbelievably basic and without context. The problem was the ads were all shouting 'free bets! Free bets!', and the consumer who wasn't used to seeing this suddenly thought gambling was all over the place, and a problem. It's something that people aren't used to and isn't completely socially acceptable. Those ads are also highly targeted around sports – football, cricket, boxing and so on – so it's even more concentrated and perceived as such."

She continued in remarking upon the difficulty of regulating advertising content itself. In a commercial world, she explained, companies need to market to customers. However, TV advertising is only one tool of many, but one which companies have been so enthused about they have neglected other media. Moreover, at the same time as gambling advertising grew, so too did pay-day loan advertising, "the put your hand up and get £5,000 advertising". As a result of this exposure to aggressive advertising for two industries with negative connotations, consumers are drawing connections between the two and with damaging results.

Steve Donoughue: "Look at every speech where politicians mentioned gambling in the same sentence as payday loan companies", Mr Donoughue advised. "These are the people who are categorising. If you look at the history of gambling, every time it becomes too prominent – in the 1920s it was football pools, in the 1960s it was bingo, it was machines in the 1980s – action is taken."

"I deal with a lot of politicians. Some of them are from the nineteenth century and most of them still think television is a modern piece of equipment. This is something they pick up on, and it's not positive. But quite frankly this is just about content and the way you do your advertising, which is something you can change."

> "Before you press the button, just think about how this will play in terms of social responsibility and how this will affect the industry as a whole."

KPMG
cutting through complexity

“I’ve never seen an industry come together and share data as well as you have in order to proactively try to solve a problem such as problem gambling.”


Wanda Goldwag

How well do you think the gambling industry manages perception?

Martina King: “The difference between perception and reality is important here. In my working career, I’ve never seen an industry come together and share data as well as you have in order to proactively try to solve a problem such as problem gambling – and you really do need to be applauded for that. The recent concern over the banning of fixed odds betting terminals (FOBTs), for example, is something to worry about and taking control, giving a different story to educate the government and the pressure groups, is definitely the right thing to do. More work like that is exactly what will start to swing opinions.”

Gilbert Licudi: Minister Licudi posed what he termed the relevant question of why this negative perception exists in the first place, to which he proposed the answer: “people think you just don’t care. This brings in the issue of responsible gambling. If it is shown that this is an industry that does recognise when problems arise, that does put in place systems and training to identify the causes of irresponsible gambling, the effect that has on people’s lives and on gambling itself, then progress will be made. We then need to show that these mechanisms are being put to use; that identification is progressing, that self-exclusion programmes are available and that ongoing support is offered. All of those things are clearly being done. A lot of effort and a lot of money goes into the problem, but it needs to be seen by those outside of the industry. We need to be perceived as being responsible and acting properly when a problem is identified.”

Wanda Goldwag: “I do think we need to be careful about different types of gambling being demonised. At different points in history, different types of gambling have been sensitised and become of concern. I’m willing to guarantee that if something happens around FOBTs in the United Kingdom, for example, politicians and pressure groups will then simply move on to the next thing. That’s why the gambling industry as a whole has to be responsible. At the moment the entire gambling industry is being represented by those machines. If those machines ceased to exist tomorrow morning, the entire gambling industry would be represented by something else. It’s very easy for us as socially responsible people inside the industry to say ‘solve this little practical problem with this specific type of gambling and it will go away’. But the public and politicians don’t see it like that.”

Steve Donoughue: “I’m going to give you some socio-cultural history, because I know that’s what you’ve been waiting for. Basically ,we’ve been through a financial crash which was caused by bankers and we’re all suffering because of these evil, nasty people. As a result, there are a lot of people who are rejecting a certain set of cultural values held in previous years. This is the way history is; we go through a period and then we reject it. What we had in the 90s was a modified form of the 80s – free market values, not a lot of morals. We’ve now gone through that and are about morals in markets. And so, what you have is gambling being considered a raw, immoral market by a lot of people.”

“What you also have is a class clash”, he continued; “because gambling traditionally has been a working class activity. Online is different, I know, but land-based is traditionally working class. That’s why is has been easy to attack FOBTs for being in areas of poverty etc. The fact is, betting shops have always been in poorer areas because that’s where the customers are. But you are dealing with decision makers who are white, upper middle class, who have never been in a betting shop and who have probably never gambled. It’s never bothered them because they’ve not had to care about it. Now it’s coming into view, and from their perspective it’s about helping people. I know we’re anti-politician, but they’re mostly very nice people who want to serve and help others. For them, rather than look at the facts and the evidence, it’s a lot easier just to ban it or tax it. If I was Ed Miliband, looking at how to deal with FOBTs, I couldn’t ban them outright because that’s £1.7 billion in tax gone. But I’ve got this online thing with a new licensing regime. I know at some point there’s going to be a scandal – so the easiest thing again, is to just raise all your taxes. Why? Because that’s simple and no one cares. No one cares if you guys go out of work.”

“So, to fight back, how about some adverts from you guys showing you training for social responsibility? How about a few adverts showing what you do in your community? Take the message that you’re providing a good service and give it to the people. People want to gamble: show that you’re providing well regulated, fun gambling.”

What should we be doing together?

Gilbert Licudi: Providing a specific example of something the Gibraltar Government will be doing as of September 2015, Minister Licudi offered Gibraltar’s first university, The University of Gibraltar, as an exciting and pragmatic response to the needs of the gambling industry, amongst others. “There are a number of things we will be doing specifically in response to responsible gambling because it’s important that Gibraltar as a jurisdiction, rather than just its operators, foster this ethos. We will be offering post-graduate courses on the causes and effects of problem gambling, leading to a PHD. This will give us the data and the expertise. We will also offer a series of short courses aimed at all industry employees and developed with the industry and its regulatory authorities. So there are a number of things we are doing as a government, in partnership with the industry, to promote responsible gambling and make sure Gibraltar is seen in that light.”

Wanda Goldwag: “Though I’m inclined to say join the Senet Group, if I was to be absolutely neutral I would say to the senior managers ‘when someone comes to you with a wonderful marketing idea that is going to bring you millions; before you press the button, just think about how this will play in terms of social responsibility and how this will affect the industry as a whole’. If the answer is it’ll make you a quick buck for the next couple of quarters but afterwards be disastrous for the industry as a whole, don’t do it.”

Steve Donoughue: “I would like to see every CEO of every gambling company personally take £200,000 out of their pocket, put it in a big pile and spend it on a home for puppies. Or something similar. You’re here and you’re trying to be there. It’s no good doing it incrementally because of regulatory creep working in the opposite direction. Each new regulator, each new jurisdiction, each new academic, just makes the argument tougher and more obscure. What you need to do is make a massive leap. We have some very rich people in this business. They should be on film, handing over money and saying ‘let’s do good with this’. The change that would make in perception, and in the lives of some puppies, would be massive.”


Martina King

Martina King: “People love betting, and I’d bet they’re going to continue betting. Most people who are betting are happy and for those who aren’t, you have started to ask the questions and address the problem. There is no easy answer to problem gambling so keep asking those difficult questions and keep working on the answers. Most importantly, do it together. If we keep working together, we will find the answers.”

“There are a number of things we are doing as a government, in partnership with the industry, to promote responsible gambling and make sure Gibraltar is seen in that light.”

KPMG
cutting through complexity

Red Carnations and Slaying Dragons

Tim Stocks

Chairman of James Stocks & Co and Partner, Taylor Wessing LLP

Tim is a lawyer specialising in corporate finance and securities work. He was a partner and Head of Corporate Finance and Securities group at international law firm, Taylor Wessing LLP where he was "highly regarded" by the Legal Directories and recognised as an expert in this area of the law. He was nominated for the "FT Innovative Lawyer of the Year" in 2013 and the team was nominated for "Corporate Team of the Year" 2013 for a transaction he developed and executed.

"As soon as you have a legitimate territory in hand and your revenues and profits are legitimate, you will attract proper institutional capital."

In one of the day's most well received and pertinent presentations, Mr Stocks introduced 'Red Carnations and Slaying Dragons' as an analysis of the bloomings of opportunity for mergers and acquisitions behaviour in the gaming market, and an identification of those companies which will, perhaps, not make the cut.

Mr Stocks then drew the attention of the audience to a statement issued by Deutsche Bank in February 2015, which read as follows: "Our view remains that the European online gaming sector will consolidate in the near term as falling industry growth rates in the UK/Europe, rising marketing costs, increased gaming taxes and rising competition make scale an increasing necessity to compete more effectively." He stated his intention to analyse whether this statement is likely to become true in the near future, as well as to determine whether M&A activity was truly reflective of consolidation in the sector or simply the 'background noise' expected of any industry.

"The first question to ask is 'is consolidation actually happening?'", Mr Stocks continued. Referring to a 'deal timeline' depicting M&A behaviour and scale, by company, from January 2013 to March 2015, he noted that activity has increased in terms of value by a significant margin. WMS Industries' £896m merger with Scientific Games in October 2013 represented the biggest of that year, alongside William Hill's purchase of Sporting Bet Australia and Sino Cement's purchase of Macau Live Gaming. 2014, however, saw GTECH Holdings' buyout of equipment manufacturer IGT for £3.591 billion, the largest of the year, followed by Scientific Games' buyout of Bally Technologies (£3.041 billion), Amaya's surprise buyout of Rational Group (£2.907 billion) and CVC Capital Partners' purchase of Sky Bet (£702million) later that year. "So we can see that valuations are rising and that there is a bit of a gap in activity between November 2013 and March 2014 as the industry sat back and thought out the ramifications of the Point of Consumption Tax. It's quite clear, however, that M&A activity is abundant but the jury is still out on whether or not that's truly indicative of industry consolidation on a larger scale."

Turning back to Deutsche Bank's statement, Mr Stocks disagreed with the assertion that the market is slowing and demonstrated that it is in fact growing quite substantially. Despite the World Bank's findings that average global GDP growth in 2013 was 2.9%, year-on-year the gaming industry grew by 8.6% overall. In 2014, growth rates dropped to 5.7%,

Tim Stocks

however year-on-year growth is expected to increase again to 10.5% in 2015 (E), 10.7% in 2016 (E), 10.7% in 2017 (E) and 10.5% in 2018 (E). "Nobody is saying that this is a sector that is going backwards or slowing down. Future growth is going to be driven, in my view, by more markets opening up, the double edged sword of regulation and as more capital opens up with increased regulation."

Looking at the European position, which concerns a more mature market whose growth rates, one would expect, to be lower; Mr Stocks again demonstrated significant growth in gaming. While World Bank average GDP growth across Europe between 2009 and 2015 was found to be 1.6%, gaming market growth in 2013 was 8.7%, followed by an estimated 9.1% in 2014 (E), 5.2% in 2015 (E), 6.0% in 2016 (E), dropping to 3.8% in 2017 (E) and 5.4% in 2018 (E). "So we can see that from the perspective of operators, particularly in the online space, the situation is rosy", he added.

Moving on to operating margins, and Deutsche Bank's comments about the market being under pressure, Mr Stocks demonstrated that this was, again, not the case. Online players' operating margins grew from an average of 17.5% in FY2012 to 19.3% in FY2014, while retail players' grew from 14.3% in FY2012 to 15.3% in FY2014. "So, margins in the online and retail space are not necessarily threatened, but they are also not that high. The question then arises; are they high enough to sustain increased Point of Consumption Tax in the UK and as other jurisdictions cotton on to it? In my view, they're not high enough without increased volume and will be squeezed, which is an issue."

Mr Stocks continued in depicting per operator marketing expenditure as a percentage of revenue, noting that on average, investments in marketing constitute more than one-fourth of online gambling operators' revenue base and marketing expenditure contributed close to one third of online gambling operators' cost base. Against an average industry spend of 25% of total operating costs, Bwin.party spent an average of 36%, followed by 888 Holdings at 35%, 32Red at 33%, Betfair at 29%, betsson at 28%, Unibet at 24%, William Hill at 13% and Paddy Power at 10%. "As we can see, marketing expenditure continues to be quite high and can probably be expected to increase, hopefully as social responsibility becomes more prevalent, and all these costs around the capture of a customer are going to carry on increasing. So, in terms of the Deutsche Bank position, I would say, yes, marketing and taxation costs are increasing. Where I might disagree is in the opinion that this is driving consolidation, rather than just M&A activity where marginal players are being picked up by the bigger players."

In terms of regulation, Mr Stocks reminded the floor that an increasing number of European countries' online gambling markets have become regulated with the rest considering regulatory changes. A comparison of 2014 over 2010 showed far more countries holding either fully regulated status, holding regulated monopolies or being in the process of drafting or reviewing regulation. "That looks like a good thing, but it's a double edged sword", he warned. "Every time a market becomes regulated, that creates more development costs, makes it more complex to operate and, generally, costs rise. However, the more you have regulated, legal gaming and the less reliant you are on grey markets, the more your reviews improve in quality, the more your profit source improves and the more the moods of your directors improve as they begin to travel from market to market without fear of being arrested."

"What this also does, and I find this to be very interesting, is as soon as you have a legitimate territory in hand and your revenues and profits are legitimate, you will attract proper institutional capital. That becomes quite important."

"Take the situation in Germany and the recent European Court of Justice decision involving the Digibet Albers vs Westdeutsche Lotterie. This trial involved a local state in Germany, Schleswig Holstein, which had issued 50 gaming licences under that state's liberal gaming act. This move was at odds with federal German law, which prohibits online gaming. The CJEU referred the case back to the German courts, with the recommendation that the licences were lawful until at least 2019. The CJEU also raised further questions about the validity of Germany's prohibitive stance based on Article 56 of the Treaty of the Functioning of the European Union. Even with this news that the German market may soon be in the process of opening up, I think we'll soon find that institutional capital will come in, which in turn will drive M&A activity."

Moving on to the USA, which was described as the elephant in the room with regards to what could be possible for future industry M&A activity, Mr Stocks explained that once the US market does begin the open up, the whole picture could change dramatically. "It has started albeit at a slow pace, having been regulated on a state-by-state basis", he added. "If you want to find a barometer for the likelihood of a state opening up I would go online and check the tax status of a given state year-on-year. If tax revenue starts to drop, the likelihood of a regulatory regime for eGaming coming into play will increase significantly."

Mr Stocks alluded to a recent estimate from Morgan Stanley which states that

KPMG
cutting through complexity

"Why is all of this for real? It's that wall of PE fund money, which is increasingly attracted to the sector and which will drive deals and valuations in the future."

the US online betting market could be worth £274.7 million by 2017. Though this estimate constitutes one-third of its initial estimate of £0.9 billion due to lower than expected domestic revenue in 2014 (actual: £93.1 million; estimated £454.3 million), he noted that a move towards interstate online gambling being regulated at a federal level, which increases liquidity with a larger number of players, will be looked for as a major growth catalyst, particularly amongst potential private equity investors. Mr Stocks reminded the floor that more than a trillion pounds of cash funds is available with the private equity funds, a portion of which can go to the increasingly lucrative online gambling sector.

Gambling focused US private equity (PE) funds have raised the maximum amount over the last ten years at £63.7 billion, followed by Europe focused PE funds at £56.8 billion and UK focused at £42.6 billion. Estimated 'dry powder' or cash like, capital – capital that has not been called for investment – available to the same gambling focused PE funds is equally healthy, with US PE funds holding £18.9 billion, Europe focused PE funds holding £13.8 billion and the UK focused holding £11.6 billion. This indicates that a large wall of immediately available dry powder cash can quickly be channelled into the gambling sector should the investment opportunity arise. Looking at the total size of PE funds available; the US holds £1.698.3 trillion, Europe holds £1.519.9 trillion and the UK £718 billion, of which £495.8 billion, £427.3 billion and £183.2 billion is estimated 'dry powder', respectively. Indeed, private equity has increased such that total assets under management worldwide have increased in value from £480 billion in 2000 to £2.538 trillion in June 2014: a compound annual growth rate of 9% despite the financial crash. "So, that little tsunami of money won't stay idle, it will be deployed. The more jurisdictions are regulated the more comfortable the private equity investors will be in deploying funds into this sector. Therefore, there will be liquidity coming in to drive M&A activity and, through that drive, a scale of opportunities to drive consolidation."

"So what's the sense of travel for M&A in the gaming sector? Well, those that go looking for gold are probably going to go looking at territories where there is no point of consumption tax. We can see that trend already underway with UK based operators focusing on Australia and going through a series of acquisitions there. So we can see that there is a surge on to try to move acquisitions and M&A activity to bigger areas where there is a regulated market and a lower cost base."

"But there are also, of course, new developments in the sector which are also of interest to operators and will be a key feature of any target selection. Social gaming for example, is a favourite because there is a big question mark as to what the regulatory status is. In the US social gaming is very popular though it remains unregulated, and there are a few who are saying perhaps it doesn't need to be. Social gaming contributes £1.1 billion to the total £23.5b billion eGaming market, and is expected to reach £4.7 billion by 2015. This is a relatively small slice but it is set to expand as it becomes driven by the connectivity of mobile devices. Global connections between mobile devices are expected to reach 8.5 billion in 2017, with Asia Pacific forming more than 50% of connections. And as developing countries like Africa come into the arena of the social gaming space, suddenly you have a whole plethora of new opportunity in this low cost, high penetration market. Indeed, overall, mobile gaming is expected to reach 16.6% of the total eGaming market in 2015."

Mr Stocks demonstrated that many online gaming operators and gaming software providers are trying to grab a piece of the social gaming space through mergers and acquisitions. In June 2014, for example, Bally Technologies announced its acquisition of Dragonplay for £59.9million. In December 2012 Caesars purchased Buffalo Studios LLC for £31.6 million and in January 2012 IGT purchased Double Down for £326.4 million.

Increased regulation has also led to a convergence in business to business (B2B) and business to customer (B2C) online gaming segments, Mr Stocks explained. Many online gaming software providers are diversifying into the B2C segment by acquiring eGaming operators, as was most famously demonstrated with Amaya's 2014 acquisition of Rational Group. This helps B2B firms achieve a larger geographical footprint, provide greater product offering and reach an increased customer base of online as well as land-based operators. Similarly, in the affiliate market, operators' acquisition of affiliates enables them to increase their customer base and expand marketing opportunities. Overall, such behaviour is part of an overall trend in the B2B segment towards acquiring in order to diversify their operations in complementary sectors.

"Moving towards a conclusion, it seems to me that, yes; M&A activity does exist within the gaming sector. I'm not persuaded yet on whether that's a consolidatory bubble for the gaming sector or a general feature common across all industries where people are toying with expansion. Technology and platform providers are going to be doing a lot of the M&A work to try to move up the value chain and closer to the customer. Looking forward, I think Europe will continue to dominate in terms of the global industry. However, the US coming onto the scene will be quite a threat in terms of the consolidation of companies away from Europe. Whilst taxation will drive behaviour in terms of international arbitrage, as point of consumption increases the playing field will become level again. Finally, why is all of this for real? It's that wall of PE fund money, which is increasingly attracted to the sector and which will drive deals and valuations in the future. Thank you."

Fiscal Neutrality and VAT

Paul Lasok QC, Head of Monckton Chambers

Paul Lasok QC

Paul Lasok QC, Head of Monckton Chambers, is considered by many of his peers as a heavy-weight in EU law where his main areas of work include agriculture, competition, public & administrative law, public procurement, telecommunications, state aid, trade law (anti-dumping) and VAT & Customs Duties.

"The principle of fiscal neutrality is very easy to express. It is that similar goods or services have to be taxed in the same way."

"The principle of fiscal neutrality is very easy to express. It is that similar goods or services have to be taxed in the same way. If the principle was that simple in practice, however, people like me would be out of business. Fortunately, it isn't that simple."

Fiscal neutrality is the application, in the context of VAT, of the principle of equal treatment, which is a fundamental principle of the law of the European Union, Mr Lasok explained. Equal treatment lies at the heart of the various rights and freedoms derived from the treaties setting up the EU. From the perspective of a business, there are two particular aspects to the application of equal treatment.

A gambling operator based in Gibraltar, to provide a first example, is entitled to set up a casino in, say, Germany on the same terms as a Germany-based operator, national, or resident. This right to equal treatment is the right to be treated in exactly the same way as somebody already based in, resident in Germany, or who is German.

A second aspect important to business is the freedom to provide services. In this situation, a gambling operator based in Gibraltar, for example, wishes to provide, say, online gambling services to a customer in Germany. Under EU law, the operator is entitled to do so without being subject to any restrictions, either imposed by the Gibraltar authorities on the export of the service, or by the German authorities on the receipt of the services in Germany.

Restrictions in this context are any prohibition, or impediment, or obstruction to the conduct of the business in the way the operator wishes. This is not just the application of the principle of equal treatment, but a straightforward prohibition on restrictions on the cross-frontier provision of a commercial service. This is because one of the fundamental aspects of the EU is the idea that the factors of production – goods, labour, services and capital – should be permitted to circulate freely throughout the EU.

"Where equal treatment comes into this cross-frontier provision of services is in this way", Mr Lasok continued. "There is an exception to the general prohibition of restrictions on the provision of services. Member states may impose some restrictions if they are justified in the public interest. There has to be an overriding public interest justification for them. But, you never get into that if the way they operate - the restriction, the way they implement the justification - is discriminatory. They have to respect the principle of equal treatment. So if, as indeed it is accepted, it is right to impose restrictions on the provision of gambling services in order to protect the public, then whatever the

KPMG

cutting through complexity

"Fiscal neutrality is the application, in the context of VAT, of the principle of equal treatment, which is a fundamental principle of the law of the European Union."

restriction is, it is only legal if it is non-discriminatory i.e. if the principle of equal treatment is respected."

Mr Lasok noted that, even if a restriction respects the principle of equal treatment, it still has to be properly based upon the grounds of justification used to support it, and it must be proportionate, meaning it cannot go any further than is absolutely necessary. There are now quite a few decisions from the European Court on the application of these principles in the context of the offshore provision of gambling services.

In general, the principle of equal treatment is expressed as the principle that persons or situations that are the same have to be treated in the same way unless there is an objective justification for treating them differently. "So you can have situations where there is some objective justification lurking around, hence you might have different forms of gambling that may require different restrictions or different solutions to the public interest in protecting consumers from the particular type of gambling in question."

Mr Lasok elaborated, explaining that, in the context of VAT, where fiscal neutrality is a manifestation of the principle of equal treatment, that principle is more usually stated as being that the supply of goods or services that are similar or the same have to receive the same tax treatment. However, "there is no further add-on in the form of an 'unless', which relates to the possibility of there being an objective justification that may lead to a difference of treatment."

The reason for this, Mr Lasok explained, lies in the structure of VAT legislation, which is derived from legislation adopted by the EU. That EU legislation is implemented by the member states. This means that the main fiscal policy decisions that may justify or result in similar things being treated differently for tax purposes are made at EU level, not by the member states. The member states implement the EU legislation. Fiscal neutrality is therefore used as a principle to interpret EU legislation but not as a means of overriding fiscal policy decisions made in EU legislation.

"When you turn to the national implementation of EU VAT legislation, however, fiscal neutrality becomes a more powerful instrument", he added. "Fiscal neutrality is there not simply to assist in resolving a dispute about obscure language and legislation; it can knock away at domestic legislation that falls foul of the principle. Hence, in the Rank case, what happened was that the same game of bingo could start off being exempt from VAT and could, during the course of the game, change into a taxed supply for VAT purposes. That was contrary to the principle of fiscal neutrality and the consequence was that the taxation of the bingo game became unlawful and the UK tax authorities had to return the tax that had been collected."

The problem of discriminatory taxation of gambling is, however, not limited to the United Kingdom, and is particularly acute in the context of VAT. This is because of the fact that EU VAT legislation requires all forms of gambling to be exempt from VAT but permits member states to limit the exemption. Member states have a discretionary power that they can use to cut back on the exemption. The member states are not required to behave in exactly the same way. They can make their own decisions as to whether or not they limit the exemption and, if they decide to do so, which forms of gambling they decide are going to be taxed.

Fiscal neutrality cannot be used to target disparities which occur in tax treatment as between different member states. For example, if Member State A wants to leave slot machines exempt and Member State B wants to tax slot machines, fiscal neutrality does not help. This is because VAT is a territorially based tax. VAT operates within a given fiscal jurisdiction and that is the jurisdiction of each member state. Where fiscal neutrality does apply is within the state.

"For example, in the case of Spain, you cannot have one tax treatment in Catalonia and another in Castile", Mr Lasok explained. "In the UK, you can't have one tax treatment in Scotland and another in England, so far as VAT is concerned. Scottish independence would change that because Scotland would then be able to make its own decisions if it were a member state of the EU or, if it left the EU, then the position becomes different again. But at the moment devolution in the United Kingdom does not alter the fact that in Scotland the tax treatment in the VAT context has to be the same as in England."

"When we look what goes on within a particular fiscal jurisdiction, and at the power of member states to limit the exemption for supplies of gambling, the difficulty we have is that member states have a free hand. It's debatable whether they can take away the exemption in its entirety. The EU Commission in Brussels seems to think that member states can, although personally I doubt that because the EU legislation permits member states to limit, not remove, the exemption. If you imagine the whole universe of gambling services, they can cut out a corner and tax that. What they can't do is tax the whole lot. They can nibble away at the edges, but something has to remain exempt."

When the member state exercises this power, fiscal neutrality comes in because the member state has to be careful that, if it decides to tax some particular form of gambling, it does not infringe the principle of fiscal neutrality. "If it does, what then happens is that everything defaults back to exemption because it is exemption that is required by the EU legislation. That's why a failure to comply with the principle of fiscal neutrality means that the tax authorities have to pay the money they have collected back. This raises the question of how we decide whether one particular form of gambling is similar to another, so that we can answer the question of whether fiscal neutrality applies and negates a particular aspect of the tax treatment of gambling in a member state."

Drawing again upon the example of Rank bingo, Mr Lasok noted a huge debate surrounding the application of the test of similarity. He explained that, in Rank, the tax authorities maintained that there had to be an element of competition between the taxed and the exempt forms of the gambling being compared. In the bingo case, because the change in tax status occurred during the course of the game, there was no effect on competition because it was the same game; "it was not a case of the people marching up to an emporium at which they can play bingo and choosing one form of bingo that was exempt over one that was taxed. The tax authorities said that was not the situation and therefore the principle of fiscal neutrality was not infringed."

"That way of looking at similarity was rejected by the European Court. Instead, we've got a test which is oriented around the objective characteristics of the type of gambling in question. It focuses on the reaction of, or the assessment made by, the typical or average customer. So if, from the perspective of the typical or average customer, two forms of gambling are interchangeable in terms of the needs that they satisfy, then they are similar. They don't have to be identical in every respect; the question is whether or not, from the perspective of the typical or average customer, they are perceived to be interchangeable, even though there may be differences between them."

Similarity is not determined by reference to such things as the regulatory regime that applies. Taking gaming machines as an example, prior to 2005 there were different types of regulation for different types of gaming machine. The fact that the regulation is different is, however, irrelevant. Regulation can be relevant but only if what it does is to have an effect on the way in which the customer's needs are satisfied by the particular forms of gambling looked at. Even then, it must be an effect that is regarded by the typical or average customer as differentiating the two or more forms of gambling being compared.

"Some things have been held to be capable of differentiating different forms of gambling such as differences in stakes and prizes, chances of winning, different formats, the degree of interaction with the customer – but at the moment these things are merely capable of differentiating different forms of gambling. The question whether or not any of them actually does so is really a question of fact that has to be answered, again, from the perspective of the typical or average consumer."

"This causes problems, because the European Court has not answered definitively how you can wrestle with things like different stakes and prizes, and so on. But there's another difficulty lurking around which is that the European Court, at different times, has regarded gambling either as a form of entertainment or as a means by which the customer gets some money. Regrettably, it has done this in relation to the same thing (slot machines). If the European Court had said in one case, 'we think that form of gambling A is one that's properly regarded as entertainment', and in another case said 'form of gambling B is a situation in which what the customer thinks he is getting – the need that is being satisfied – is the need to get some money', then we would have quite a reasonable basis for the start of a debate. But the problem is the European Court has made this judgement in relation to the same form of gambling – slot machines."

Mr Lasok referred the audience to a case known as RAL, which involved a supplier of slot machines in amusement arcades in the UK. The argument put forward by Mr Lasok, was that in the case of the supply of slot machines what the customer really wanted was the chance of getting money, not entertainment. "The European Court said 'you must be joking, it's all entertainment'. Then, in the Rank slot machines case, several years later, the European Court looks at slot machines again, has forgotten about the RAL case, and it suddenly pops up with the pronouncement that in the case of gambling generally and including slot machines, what customers are after is the opportunity to win – not simply amusement or entertainment."

"Now, if a gambling activity is regarded by the average or typical customer as a form of entertainment, as many gambling activities clearly are, differences in stakes and prizes or in payout, even differences in the chance of winning, begin to look irrelevant. Indeed, on the evidence they may not be relevant at all. Particularly, differences in format might be more important, because one can easily see that some formats look obviously like entertainment whereas other types are a bit ambiguous."

"If you take the example of a punter who goes into a betting shop, lays a bet on the outcome of a horse race, and then hangs around and looks at a television screen or monitor and enjoys a horse race, what is going on? Is it entertainment, or something else? The difficulty with the scenario I've just described is you can look at it in more than one way. You can say that there are two events or experiences going on. One is the experience that the customer has of placing the bet in the anticipation of something. The placing of the bet is meeting some particular need. What is that need? Another experience he's having is standing around looking at that horse race and enjoying the excitement of the race. What is that? That is, in all probability, entertainment. His sense of interest in being entertained by the event may be enhanced by the fact that he's placed a bet, so he may be more interested in that race than the one immediately before or after it. But, in any event, his experience through watching the screen or monitor is an entertainment experience but is separate from that which he had when he placed the bet."

"So you can argue that the two experiences are different, and you can argue that the two experiences satisfy different needs on the part of the average or typical customer. And if you separate them off, you may say that what is really spurring the customer on when he places the bet is not a form of entertainment but something else; something that you don't see in a typical game of chance in which there is more of a sense of the customer striving to win, to beat the machine or other players. But this kind of beating is not necessarily getting money, it's the struggle."

"What I have just explained is where we currently are in the application of fiscal neutrality in the context of gaming. The way I've put this may appear to you, as people who are in the industry and therefore rather better informed than lawyers and judges are about what goes on in the context of gaming, rather crude or simplistic. But at the moment, in terms of the development of a kind of legal understanding of how you can apply fiscal neutrality within the context of gaming, that is where we currently are."

"In the Rank case itself, there wasn't all that much debate about similarity from the perspective of the average consumer because in the bingo case, bingo is bingo; the change in tax status occurred during the course of the very same game. In slot machines, the main groups of slot machines we were comparing were accepted to be similar in terms of their objective characteristics, but the debate was about other things that were found to be misconceptions by the European Court."

"The exercise that I was doing in front of the UK Supreme Court, which [at the time of writing] was the latest development in the Rank trial, was about the interpretation of the UK legislation enforced, in effect, from 1968 to 2005. It was a pretty recondite and arcane debate not least because it was focused on legislation that no longer exists, but here the debate touched very tangentially on the question of similarity as it arises in the context of gambling."

"We don't know what is going to happen or what the Supreme Court is going to decide. Whatever it does decide will determine what will happen at the next stage of the Rank litigation because this stage, which may or may not happen, is going to be an argument about similarity as between FOBTs and certain types of gaming machine that were around at the same time as FOBTs, and which were taxed at the same time as FOBTs were exempt. That's going to get into some of the issues that have been left unresolved by the European Court in its decision about the Rank case. I also ought to mention that in Rank, when we were looking at the question of similarity - although as I have said the arguments didn't need to be developed fully - we ended up with evidence largely from people within the industry, from manufacturers and operators. This isn't the best kind of evidence to submit in many of the member states because if you're looking at the question of similarity from the perspective of the average or typical customer, then you need to have evidence more closely calibrated to observable customer behaviour. What you want in order to demonstrate similarity is evidence that shows, to provide a basic and not entirely accurate example, that if a customer walks into a betting shop and is faced with two rival things, does he dither because he's going to have to choose one or the other? If, on the other hand, his reaction is 'that one is definitely different from that one', and he goes straight for the one he prefers, you then have got the very strong likelihood that you're dealing with something that isn't similar."

Mr Lasok explained that his presentation thus far had encompassed the fiscal neutrality debate to date because many issues remained unresolved. This is because there remains significant difference in treatment, member state by member state, concerning forms of gambling that are either actually the same or similar enough that the principle of fiscal neutrality is likely to apply. Moreover, there exists regulatory rules which are very often associated with the tax position, whether they be the application of VAT or a non-turnover tax such as a betting or excise duty.

"In many instances what the member states are doing is highly questionable either as a matter of VAT law or as a matter of the rather more general principles of EU law which are based on equal treatment but also concerned with ensuring that there is true, unrestricted freedom to provide services from one member state to another. So, we're in interesting times, we can see there are judgments coming out from the European Court on a number of these points which are showing that there are a lot of questions that member states have to answer."

"There are a lot of questions that member states have to answer."

KPMG
cutting through complexity

Panel Session: The Evolution of Gaming – The Operators' View

Moderated by:

Peter Montegriffo QC, Partner, Hassans

Peter has advised on numerous financial services, regulatory and trust related matters. He was closely involved in the IPOs of various gaming companies established in Gibraltar, which have been listed on the London Stock Exchange, and has been closely involved in drafting numerous changes to Gibraltar's legislation in trusts, financial services and gaming areas. His knowledge of these fields has led him to contribute to a large number of articles and books on Gibraltar's legal system and financial services sector. Peter regularly speaks at international conferences relating to these areas of practice and his work frequently requires him to deal with multiple jurisdictions. He is a member of the pre-eminent global gambling law networking and education organisation, the International Masters of Gaming Law. Peter was also Gibraltar's Minister for Trade and Industry, with responsibility for economic development and financial services, between May 1996 and February 2000. Peter was appointed as Queen's Counsel in Gibraltar in June 2014.

Panellists:

Pat Harrison, Operations Director, 32Red

Ralph Lichtmannegger, Head of Customer Relationship Management, digibet Ltd

Martin Weigold, Chief Financial Officer, bwin.party digital entertainment plc

"We are at a point of reflection;", Mr Montegriffo opened, "with the UK General Election under way, with the PoC tax in the UK potentially coming to a resolution in May, with the judgment to follow, all of which will set the pattern for what will happen in Europe. We have perhaps a more sanguine and balanced view of the way in which the US is likely to pan-out. So, as we stand here in the context of that environment:

What more should we be doing to reboot the industry after this period of uncertainty and reflection?"

Pat Harrison: "For us it's not necessarily a reboot but more of a recalibration. This is a theme that was touched on in this forum last year when we were talking about challenging the UK's then proposed regulation. One thing that Paul Leyland observed very keenly was the fact that as operators we were very disparate. We didn't have a uniform voice and didn't represent ourselves very well to politicians or regulators. I think that theme has certainly been picked up again today. For me, that recalibration means that as operators we need to be working together and in unison to regulate what we do –to make sure that there's one single voice – and act in a way that removes that air of suspicion that seems to hang over us all the time. For me it's about getting our act together, working together and getting almost to the point of self-regulation. We're very good at being innovative and creating solutions to problems, let's have more of the same; present a united front to the people who make decisions and make the decisions ourselves."

Martin Weigold: Mr Weigold agreed, adding that Gibraltar's campaign against the UK's taxation proposals was in some respects a positive step forward in the industry's ability to act with a unified voice. "Certainly, we can still do better on that front. Whatever happens, gambling is always going to be regarded as a sin-stock and political football; it's never going to be a nice, fuzzy market. So, for me it's about making sure we educate the regulators and the government the whole time, a constant engagement programme. Once governments have made their mind up it's very difficult to reverse the process, as we found out in the PoC discussions with Treasury."

"Present a united front to the people who make decisions and make the decisions ourselves."

Peter Montegriffo QC

Peter Montegriffo: "Given that so much of the problem seems to be of perception rather than fact; how far do you get by pushing the facts?" Mr Montegriffo asked. "Even if you push the facts with the policy makers, it seems a large part of the problem is the tone of the industry – the tone of the adverts, the way the industry puts itself about. It seems to me to be a matter beyond empirical evidence when dealing with politicians and the public. Would you say that's fair?"

Martin Weigold: "I think that's a fair point, and if you're alluding to the fact that there is a lot of advertising for gambling products in the UK then I do think that could lead to further regulation. Unfortunately, cutting back on advertising is not something that will be easy for the advertisers to mutually agree, particularly if that market is your main area of focus."

Is this a broader European issue as well?

Ralph Lichtmannegger: "Broadly speaking yes. Digibet are not involved in the UK market any more due to the recent changes, and we were always in support of what was being done by the GBGA towards the UK authorities on the matter. It is important to have one voice; this is a core market which could have a spill over effect for our markets in Europe. I do believe that we as a sector have a lot in common and to battle against in any jurisdiction. Working more closely together in the future can help us."

How are the different factors affecting how you reach clients impacting who you are reaching and retaining?

Pat Harrison: "We have certainly seen drastic changes in the ways people are accessing our products, but for me it's more about how you reach that audience. What is changing, for example, is how the younger generation views TV. Very few of a certain generation sit there and watch scheduled TV programmes; they choose what to watch when they want to watch it, making getting your product in front of them very difficult."

Martin Weigold: "In certain areas we are seeing changes in demographics. As you would imagine, the demographic split is heavily male focused for us, at around 87%. FoxyBingo, however, is skewing the other way at 76% female. That split across the brands is relatively stable. However, we are seeing across the age groups - and about 60% of players are in the 18 to 34 bracket – a slight skew towards the younger players. I think that mobile and touch devices are a driver of that. That move is not overly significant however, so I don't want to over-emphasise it. We have seen an increased propensity amongst males to use mobile and touch screen devices, but I think that partly reflects the fact that the bwin brand enjoys a very male biased group of players placing sports bets, and obviously mobile is very helpful for live betting."

Ralph Lichtmannegger: "We are definitely seeing more female signups as well as more people aged 60-plus using our services. Having said that, it's sometimes not so easy to determine who's actually placing the bets. It could be that the traditional, younger male clientele wants to receive their bonus for the extra sign-up. The verification process runs smoothly with full due diligence, so on paper we're seeing more female sign-ups and on paper we're seeing more 60-plus users, but we cannot be sure who is actually placing the bets then."

What has held back a more determined industry consolidation and what will the next 12 to 18 months produce?

Pat Harrison: Mr Harrison confirmed that there are certainly more drivers for consolidation, particularly within the UK. He noted, however, that the 'year of consolidation' has been heralded for some time without being realised. He voiced his concerns that the investment community is scared of engaging with currently volatile gaming stocks, adding that one area of concern lies in convincing the investment community of the transparency and quality of listed gaming companies and their likely commercial trajectory.

Martin Weigold: "Let's not overlook that there has been some pretty significant transactions in the sector recently – like Amaya's purchase of Rational. I expect further consolidation will play out – we've said it publically. We think there should be further consolidation in the sector and intend to play an active part in the process. Indeed, we are in talks with other parties at the moment."

The argument for consolidation, Mr Weigold explained, is certainly apparent. Operational costs are rising with the move to nationally regulated markets, requiring companies to acquire scale in order to absorb those costs. Gaming duty, bespoke platform development and processes are similarly costly, as is competition from new-entry land-based incumbents. "The drivers likely to slow consolidation in the sector tend to be the markets where operators generate revenues and profits from. You would be quite surprised by the difference in opinion concerning the legality of operating in certain markets and how sustainable those markets are."

"Another issue can be with respect to the valuation aspirations of large shareholders in certain companies; whether or not a deal can be struck that gives the buyer the return they're looking for and the vendor the exit they want. Then another factor which introduces uncertainty to the process has been to what extent the VAT issue will affect companies. This has been anything but a straightforward exercise and all companies have been looking at the VAT law in each jurisdiction and how that interacts with EU law before deciding what approach they will take. That process is now largely behind us and I've been quite surprised at the degree of unanimity in the conclusion. So I think a lot of the stalling is down to the degree of uncertainty operators have faced. Lastly, with respect to the UK, operators have been waiting to see, when looking at smaller operators, what impact the UK's PoC will have."

Ralph; what are your expectations concerning the current court proceedings in Germany and their likely repercussions?

Ralph Lichtmannegger: "I've been in the industry for ten years now and in Germany I've not known anything other than uncertainty. I wish I could share some facts and figures, but I'm stuck with reading tea leaves. You can ask five different lawyers about the potential outcome in Germany, but I think your money is better spent on a fortune teller – at least then you know the prediction is incorrect. Germany does not allow for mid or long term planning and as one of the smaller operators we suffer: we need to see how long we can maintain operating in this grey area whilst at the same time shouldering the tax burden and uncertainty, and the impact that has on our offline business too. I would have hoped that by now we could see some light at the end of the tunnel, but I now doubt it's going to be resolved any time soon. Until I hold a licence in my hand, I remain sceptical. We can happily live in a grey area, and have done so for many years, but it's not enjoyable. We need a clear cut case to encourage investment. Perhaps if a limited number of licences are issued in Germany we'll see some movement."

How do you see the emerging potential of decentralised applications, cryptocurrencies and the blockchain?

Pat Harrison: "We've all got our concerns, which are once again borne out of regulation – the source of funds and KYC stuff. What is different with this particular aspect is that merchants, operators, all sides of the equation, seem to be working together to try to convince regulators to take a look and see if there's something we can regulate in the future. In terms of accepting cryptocurrencies and would we do it, well potentially we already have because you can fund your Neteller wallet with Bitcoins. But I don't think it's going to change the world. I think the greater potential lies in the technology that underlines the Bitcoin platform. I don't really understand it I'm afraid, I'm sure there are people here who do, but apparently it is the next thing since sliced bread."

Martin Weigold: "My view on Bitcoin is it sounds quite interesting for the future, but right now it's not particularly exciting for us. About one in two thousand people have a Bitcoin account, and we operate in regulated and taxed markets, so it's unlikely we're going to get any incremental deposits simply by offering Bitcoin. All of our customers have a range of payment options available to them and don't require another one. There have been a number of issues with accepting it and a number of companies are coming up with solutions for that, which is good. But volatility aside, it gives rise to a number of issues and we've been told by our principal bankers that if we were to accept Bitcoin it could cause internal issues at the bank. Our policy is very much a case of wait and see. That's not to say that there isn't a role for Bitcoin in online gaming, however. A lot of smaller operators in certain markets – Africa, Asia – could well find a use for Bitcoin, and perhaps make some additional revenue from the spread on conversion. If the currency was regulated, however, that would be a very different situation."

How do you see the industry evolving over the next two, then five years?

Pat Harrison: "I'll start with five years hence, which will hopefully be as vibrant as it is today with plenty of choice for the consumer. The challenges are that those choices will be eroded because of the expense of operating and you'll have two or three big players who will dominate the markets. Short term, I think we'll see a period of consolidation. Not consolidation as we were talking about earlier, but a chance to get back to running our businesses after the distractions of licence applications, legal fights and so on. Let's get back to running our businesses, working together and looking at self regulation."

Ralph Lichtmannegger: "Our business is one of the present, more than the future. However, I would like to see the regulatory burden lifted for the industry to work together on that agenda. We have a few very good bodies working towards harmonisation, but this is still very far off and quite an idealistic viewpoint."

Martin Weigold: "I agree, and would add that in the next two years we'll see more transition to nationally regulated markets with the inevitable squeeze on margins that will bring. We will see as a result some consolidation playing out and I think we will see operators focusing on fewer markets. You can have a substantial marketing budget, but if you're targeting 20 markets, your voice in each becomes irrelevant. So with nationally regulated markets we'll see operators focus on select jurisdictions in the hope of becoming a top three player in those. As we look further out, I would like to say that the US will have opened up a little bit more and I think there will be new, unforeseen technologies coming into play. That has always been a big driver for the industry and will be in the future."

Peter Montegriffo QC

"The greater potential lies in the technology that underlines the Bitcoin platform."

"Let's get back to running our businesses, working together and looking at self regulation."

Panel Session: The Evolution of eGaming – The Regulators' View

Moderated by:

Dr Joerg Hofmann, Melchers/ President, International Masters of Gambling Law

Dr. Joerg Hofmann is the current President of IMGL and the group leader of the gaming law practice group of his law firm. Joerg has practiced in gaming law since the mid-90s as one of Germany's leading gaming lawyers. MELCHERS' legal advice is highly valued by global market leaders in all sectors of gaming law. Joerg has been ranked as a "Leading Individual" in Gaming & Gambling by Chambers Global frequently since 2011. He regularly publishes articles in international experts' magazines and periodicals and serves as a member of the editorial board of Gaming Law Review and Economics.

Panellists:

Phill Brear, Gambling Commissioner, Gibraltar Government

Jenny Williams, Chief Executive, UK Gambling Commission

Hakan Hallstedt, Director General, Swedish Gambling Authority

"Without proper analysis in partnership with the regulator and the industry some policies just scratch the surface, often the wrong surface."

"It goes without saying that the role of the regulator is important," Dr Hofmann opened the morning's proceedings. "The quality of regulation and its practical implementation is significantly dependent on the quality of the regulator; on her accessibility, personality, willingness to continue dialogue with the industry and, of course, her knowledge and understanding of the business. Most, if not all, regulators like to describe themselves as independent, but;

to what degree is your regulatory body independent and who is it independent of?"

Phill Brear: "This is a subject that regulators occasionally find themselves dwelling on. Some regulators have perhaps overplayed their independent status for different reasons. My starting point has always been that regulators are not just creatures of statute, products of legislation; we're also products of subordinate legislation i.e. statutory instruments and regulations. A regulator who isn't sufficiently attuned to the principles of the base legislation or the priorities of the relevant political department will pretty soon find him or herself in a tricky situation, be that around other policy issues, possibly even funding. Whilst these may be some uncomfortable statements to make, and might even be denied in some places, I can think of very few regulators who are not acutely tuned in to politics."

"Here in Gibraltar, where it is such a tight community, in some ways that relationship is amplified. It's essential that you are tuned in. But I would draw a line under that and say in a place like this, if you are at odds repeatedly or significantly a democracy says it's the regulator who walks. So, I would say I'm professionally independent and if we ever reached the stage where there was a significant issue where you are at odds with the government then you would have to, as the press would say, 'consider your position'."

Joerg Hofmann: "I understand, of course, you have to execute the law. Sometimes regulators feel like the provisions provided to enforce that are maybe not the best practical solutions. The regulator may feel there are restrictions which create non-competitiveness, which are bad for the market and the operator. They certainly are independent, but to a certain extent you have to not follow your own opinion.

How do you deal with this kind of conflict in practice?"

Phill Brear: "You have to be able to give advice using the multitude of communication channels available to you, which we're able to do here – advice is never unwelcome. But I'm speaking in the abstract: we've never reached a point where we've had a difference of opinion. There have been situations where I've felt it necessary to give early and very comprehensive advice, and I've had to give it more than once, but fortunately we've never reached that situation where the ability to persuade has even been stretched. In Gibraltar, the government's objectives and my values are very well aligned."

Joerg Hofmann: "This week, we heard reports about an unnamed group of Danish gaming executives who encouraged the Swedish Government to steer away from the Danish licensing model in favour of the British. However, the Danish model, at least legally, has been a popular model for other jurisdictions. **Are the British and Danish models so distinct that one is more attractive and suitable to Sweden than the other?"**

Hakan Hallstedt: "One can say that the current development is really changing the fundamentals of the Swedish gambling landscape," the Swedish regulator explained. "We have two state concessions at the moment, Svenska Spel and ATG. Both are state controlled companies, both are showing little or negative growth and are in deep conflict with the interests they are there to defend, namely the funding of horseracing and giving a lot of money to the state budget. The same goes for the good causes lottery, which is fighting a losing battle in retaining their customers. There has been a political discussion for many years; we've had several enquiries, in order to perhaps change the landscape. There is a majority of 87% in the Swedish Parliament who are for having a licensing system and the minister responsible went out and said we're going to start an enquiry as soon as possible. This will, of course, take a couple of years and already there are heaven and hell scenarios put forward by everyone. We're going to earn more tax revenues, but the other side is mainly concerned with responsible gambling measures."

"When we conduct the enquiry one of the issues will, of course, be tax. We have 15% in England and 20% in Denmark. The politicians will, I think, find that if 20% works in Denmark then why bring it to 15%? They may, however, not have as low level as either. Concerning responsible gambling, Svenska Spel introduced a lot of measures, but they would have to lower the bar in order to be able to compete with the newer licensees, which would be a tough sell in the political sense. We also have to discuss what we're going to do with these monopolists. In Denmark, Danske Spil has been subject to a lot of criticism due to its maintaining quite a huge advantage. We will have the same situation when it comes to branding and the retail system. So, there are a lot of aspects and we'll look at all the possibilities."

Key to this discussion is the affordable amount of burden for the operator in terms of taxes and fees; could you elaborate?

Jenny Williams: Ms Williams explained that the British and the Danish systems are in fact very similar, differing only in tax rates and the Danish requirement for real-time provision of data, complete with specific software arrangements. In the UK, operators are also expected to keep and make available to the operator specific records, but not real time data provision with a specific data safe which constitute an additional cost to the operator. "I would certainly question whether that's necessary, and it is certainly something the Swedish authorities may want to consider. But aside from that and tax rates, there really is very little to distinguish the two."

Joerg Hofmann: "Svenska Spel introduced some very restrictive responsible gambling measures, specifically player cards and a prohibition of bonuses and other gambling offers.

"The way you act and really are is of major importance to how your jurisdiction works."

Joerg Hofmann

Phill Brear

What affect will these measures have on the market – are they helpful or harmful to the market and its players?"

Hakan Hallstedt: "Svenska Spel had a lot of government encouragement when it introduced these measures. They tackle issues of integrity and facilitate the KYC question. They also help with AML measures because you are certain who's playing. These are advantages, but at the same time there has been a clear loss of customers. The slot machines are losing customers annually, as are other forms of gambling. Sweden is looking at a loss of €60,000,000 on its bottom line due to the introduction of the player card."

"It is, of course, a goal for Sweden to channel as many players as possible to the legal operator and I don't think this measure will make those numbers get any higher. At the moment 57-58% of the online market is abroad – less than half of the online market is in Sweden. This raises issues of protection, particularly in the slot machines industry. Those machine players with gambling problems may, in the worst case, gravitate towards unregulated online sites where they may not be offered protection. So there are up sides and down sides."

Joerg Hofmann: "In a way, I feel there is a degree of ignorance surrounding the black market. If you really want to protect players then you need to introduce measures which will be successful in doing so. In Germany, we have total prohibition on online casinos to protect players from gambling addiction. The result is some players find their way to the black market, which is massive. This market is totally uncontrolled, totally unlicensed and totally unprotected. Are we successful in practising these measures, or does it make no sense? Moreover, many of the discussions on this matter are controlled by politicians and lawmakers, many of whom have very little knowledge of the online gambling market. I would say it takes time. You make little adjustments and you correct your mistakes over a long term period. Do you see this happen in Sweden as well?

Do you think prohibition is justified in the protection of players?"

Hakan Hallstedt: "I think it's very clear that the training of politicians, enlightening them using the benefit of industry and regulators' experience, is important. We have a very high level of protection, but it's important to also offer balance in order to attract the licensees. The politicians are the decision makers, we have to hope that they will listen when we say what will, what won't and what might work. It's going to be a tough sell and a long, tiresome journey to the end but we didn't go to the moon because it was easy. It is a discussion that needs to be had and I'm glad we're finally adapting to the rest of the free world."

What is the discussion in the UK surrounding competitiveness and protection?

Jenny Williams: "There was a long discussion about the fairness and openness of bonuses, and certainly some people in the industry have been irresponsible in the way they offer their bonuses. Yes, it hasn't done any good in managing perceptions of the industry and we are taking steps and working in that area. Looking at it the other way, from the customers' point of view, free bets and bonuses are enjoyable. We're not in the business of stopping the normal, healthy gamblers getting fun from what they're doing. All we're worried about is people being misled or spending more than they perhaps should. It's a difficult balance: letting people have fun but measuring the activity to stop them getting sucked in. We're very interested in pushing the debate and exploring what works."

"Something else to consider is whether or not prohibition will encourage others to go elsewhere. Prohibition of FOBTs, for example, could lead players to other machines, other forms of gambling. One of the problems we have in the UK in this regard is the anonymous use of cash in these machines, which makes it very difficult to monitor player behaviours and develop measures for protection. So there's a real political policy trade-off. Should we, for example, be encouraging the use of player cards in order to get better data and see what's happening to people? But there are of course huge privacy and utility loss issues there which are very much political decisions. It's not for the regulator to decide where the cut off ought to be in allowing people to do harm to themselves or to ask people not to over-indulge from time to time if they want to. So this debate about introducing player cards for high-stakes betting is something we really need to engage in with the politicians to help them understand what the tradeoffs might be."

Joerg Hofmann: "All the regulators commit to measures to prevent problem gambling, but in practice a problem gambler can easily circumvent even the strictest controls.

Where should the line be drawn – the government, the regulator, or the problem gambler?"

Phill Brear: "This follows on from what was said at the beginning. Without a proper dialogue, you get policy led by assumption rather than policy led by analysis and evidence. I see and hear too often on the world stage policy decisions and statements that strike me as knee jerk, or reactive. We see policy delivered under the assumption that it is helping problem gambling, but without proper analysis in partnership with the regulator and the industry some policies just scratch the surface, often the wrong surface."

Jenny Williams: "There is often this gloss where the industry says there is no evidence with which the policy makers can choose X or Y. But there is no evidence if you don't look for it. That is something we've been working very hard to do, that is ensure that decisions are made on an evidential basis and in partnership. But it takes the engagement of the industry as well as the regulator."

Joerg Hofmann: "What we're looking towards is dialogue; dialogue between the industry and dialogue between the regulators, particularly on cross-border issues. There are different types of regulators; those who educate themselves by taking part in the industry and those who rarely see outside of their office. Indeed, I would like to thank you all now for being accessible and for taking part in this dialogue, because it is important for the industry. I was very impressed earlier to hear of the relationship between the ministers here in Gibraltar and the industry. I was also very impressed to hear that the industry today is bigger than it has ever been. Phill;

Is there any point at which Gibraltar's growth must stop?"

Phill Brear: "I think this goes back to my first point about independent and rational thought. The issue for a place like Gibraltar is more macro-economic than regulatory. As a part of the infrastructure we have the support services, the legal profession, the accountants and auditors, and so on. In Gibraltar particularly there has to be a management of the economy to ensure it doesn't become either over-dependent economically on a particular function, or that one function starts to hamper the ability to populate and pay together services which may or may not be ancillary to that function. The legal function here does rely to some extent upon the gaming industry, as does the accountancy. But at the same time there are young people in Gibraltar who aspire to be trained accountants, lawyers, bank clerks, shop-keepers, ship maintenance people, teachers and all the other professions aside. If the gaming industry became too intense you would start to get upward pressure on pay and downward pressure on the availability of skills. So, I think the question of scale in Gibraltar is to an extent regulatory, but I think it's more a macro-economic one."

"I keep asking politicians not to use the term 'selective licensing'. It's actually just that we have a higher bar to entry. We can keep raising the bar as high as we want, but we can't unilaterally discriminate against those who meet that high bar simply because we've got too many. So, yes, the industry can get too large for macro-economic reasons, but I can't think of it as a regulatory issue or of a regulatory ceiling which I could legally impose. It's an area about which, if we were getting close, we would have to have a very well thought out discussion. It would be a question of 'is it getting too big?' rather than 'has it got too big?'. I don't think it's too big now, and I'm not quite sure what too big would look like because of this broader economic question of viability."

How important is the regulator's independence and personality?

Jenny Williams: "the point about something like the UK Gambling Commission as an independent regulatory body isn't solely its ability to regulate the industry within government frameworks. Where the importance of independence lies is in casework. We are absolutely independent on casework; we don't discuss with any government department any details about investigations and they have no influence over decisions on a licence holder. I think that's a very important feature of British and many other regulatory systems, and that's an important safeguard for the industry. In terms of personality one of the things we try to do as a regulator is ensure proportionality, openness, fairness, willingness to learn, openness in consultation, all those buzzwords throughout the organisation and if that ceased to be when I leave the Gambling Commission then I would have failed."

Hakan Hallstedt: "I talked to the CEO of a major lottery company just a couple of weeks ago and asked what impression he would leave when he left. He said, 'take your hand, put it in a bucket of cold water, take it out again and look at the surface; that's the impression I'm going to leave behind'. We're all easily forgotten, but if the frame is clear it should be filled with the right competence in the perfect world. At the same time, it would be stupid to reject the importance of personality and openness in the regulator in every case. Of course, the way you act and really are is of major importance to how your jurisdiction works."

KPMG
cutting through complexity

The Multi-channel Value Equation

Paul Leyland, Partner, Regulus Partners

Paul was an Equity Analyst in the City for over 10 years, among the first to be focused on the gambling sector. He researched and reported on small and large gambling company stocks, as well as advising many companies in relation to IPO and M&A. During his time in the City he worked for a number of investment banks, most recently Investec and Collins Stewart (now Cannacord).

Following on from this, he moved into the industry, as Corporate Development Director for leading gambling company William Hill, advising on retail strategy, regulatory issues, the racing industry, supply chain management, and M&A. Paul has proven strategic and analytical skills, as well as in depth sector knowledge and a broad range of industry and professional services contacts.

> "What that channel shift can essentially mean is that you lose the money on the land-based side and you don't make it all back on the remote side."

"I want to talk this morning about a buzzword that's flying round the gambling sector, 'omni-channel', which is particularly relevant to the UK retail businesses but also to other operators from a competitive dynamic," Mr Leyland began. "Retail gambling businesses in the UK have been attempting to be successful remote operators for fifteen years or so, with more failures than successes. During that time they've all said an awful lot about being "multi-channel" before some point last year when being multi-channel was no longer good enough. Everybody is now "omni-channel"; a word which is now peppering the dialogue of nearly every large operator and supplier: nearly all are now hiring to deliver it."

Mr Leyland continued in explaining that the dialogue around omni-channel has also, and inevitably, all been very positive. Omni-channel is deemed to be an important growth driver for land-based businesses in the remote gaming space. Mobile is now ubiquitous, with a much more convergent customer base which means that mobile and land-based can no longer co-exist without the risk of cannibalization. Countering that, there are a lot of operational benefits in terms of the increased ability to leverage a brand with a single customer view. Omni-channel enables companies to create a centralised digital living space, complete with a single, cashless wallet within which customers can view any medium, anywhere and at any time. This in turn allows companies to rebuild presence, improve service, enrich content and square the payments circle with lower costs of customer conversion and stronger retention capabilities. "What's not to like?"

Multi-channel has become so big it has had to be renamed. Indeed, as Mr Leyland explained, the benefits are not just limited to the gaming space, with the ordinary man on the street now already accustomed to omni-channel marketing from the majority of large retailers. "So it's here, and it's a very important driver, but what I want to flag this morning is that omni-channel is not necessarily the force for good that everybody seems to think it is. In fact, it is potentially a fairly weak mitigator of some dangerous and offensive behaviour."

Mr Leyland then drew the attention of the summit to a table demonstrating market share within the betting, casino and bingo retail sectors. Retail gambling was shown to be growing fitfully for the past five years, whilst remote gambling has been growing at double digit percentage rates. In being encouraged to enter the remote gambling space, the retail sector's traditional customer base are introduced to a more competitive and fragmented market which forces retail businesses to compete aggressively online and reduces overall revenue for high market-share retailers.

"What this demonstrates," he explained, "is that a lot of landbased operators, successful ones that have been around for a long time, tend to have a quite high market share in their given retail sector. It is something that is a given in pretty much every market, including the competitive commercial UK market. The problem is, the remote sector is structurally a more competitive, fragmented and dynamic one and it can always, even in a taxed and regulated environment, support more operators. Consequently, it's almost impossible to deliver the same market share in remote as you have in land-based, even if you're very good at online. William Hill, for example, which has got 30% market share in terms of shops in the UK is running at about 13% in UK online overall – and there's a very long list of land-based companies who haven't done anywhere near as well as that."

"The problem with that is that if customers are increasingly choosing to use remote channels as well as, or in some cases rather than, retail channels; those customers start to become exposed to a much greater number of operators. It becomes much more difficult, then, to control the market share in the remote environment as it does in retail. What that channel shift can essentially mean is that you lose the money on the land-based side and you don't make it all back on the remote side. That is a clear reason why land-based operators have to engage in omni-channel. This is the real reason for omni-channel and it is a negative one, not a positive one."

For omni-channel to be the good thing that everybody is talking about, Mr Leyland noted that it is very important to get the retail experience to reflect the remote offering and for it to be much more dynamic and engaging, and not merely transactional. The transactional gambler can now be persuaded to use remote devices rather than travel to a retail location because it is much simpler. "The retail location has to give something better, something different, and in the UK innovation is not something we've seen very much of at all. The remote offer also mustn't be so poor that it damages the overall brand and this is a problem that a lot of land-based businesses in the UK have. If you've got a high market share of casinos, betting shops and bingo halls you can take money off customers even if you haven't invested in those assets for quite some time. If you put up a poor online or mobile offer, people will spot it as being poor very quickly. If you don't deliver the market share that your brand should deliver it will start to tarnish the business. Retail businesses can't just be online; they have to be incredibly good online."

Mr Leyland added that the remote division for retail businesses is a very big challenge. The market share of migrated customers must be sustained otherwise a land-based business risks losing money by going online. The offer also needs to complement the retail offering and stand out from other remote offers, which is a problem that a number of land-based businesses have. "It's this lack of differentiation. If you have a completely vanilla offer that looks exactly the same as the remote only operators, but the remote only operators have some pretty important built in advantages then you're going to immediately suffer. We've already seen that in action with the poor market share of Ladbrokes, or Gala Coral or Rank, compared to the excellent remote offerings of, for instance, Bet365 or Paddy Power. The remote operators can be an awful lot more dynamic than retail businesses. It's incredibly important for the omni-channel operator to bring that dynamism in. The remote businesses have it already and it's very, very difficult to migrate across."

> "The good thing about a single customer view is you do get a lot more data on what a customer is doing. It's right and proper to use that data to maximise your response to problem gambling and social responsibility."

"But omni-channel is also a bit of an issue for regulators and tax collectors. There is the potential to arbitrage product. In an environment where customers are much more relaxed about choosing between retail and remote, having a rigid set of product regulations in terms of stakes, prizes, coupons and that sort of thing, while having a free for all in the remote environment as channels become more fungible is going to cause a lot of headaches. It puts the land-based sector at a considerable disadvantage against the remote sector, potentially accelerating its demise."

"There's also the potential to arbitrage tax. A casino in the land-based environment in the UK is taxed up to 50% against only 15% in online. You can also structure your business in a remote environment in a way that you can't in a land-based, which is something the government is already attempting to correct. So, omni-channel isn't just an operational driver or a customer driver, it's going

cutting through complexity

> "Is omni-channel a good thing? It's necessary, because if the retailers aren't competing effectively online then they aren't going to be competing at all in the medium term."

to start driving the regulatory environment as well."

"Going back quickly to what we were talking about earlier; the good thing about a single customer view is you do get a lot more data on what a customer is doing. It's right and proper to use that data to maximise your response to problem gambling and social responsibility, but it's also certainly going to be the case that that data gets kicked about, politicised and potentially encourages regulatory change to the economic disbenefit of the sector."

"So, is omni-channel a good thing? It's necessary, because if the retailers aren't competing effectively online then they aren't going to be competing at all in the medium term. But it's not necessarily good. The problem with omni-channel is that to be a credible omni-channel operator you need a large scale retail estate and it's very difficult, in an environment with an increasing channel shift, to see where the growth in that retail estate is coming from. So, to be a good omni-channel operator you're effectively saying you're going to be shackled with a large, declining retail footprint, whereas a remote only operator can focus entirely on growth. Or, if you're an omni-channel disruptor like Paddy Power, you can choose exactly where you're going to place your shops for maximum omni-channel benefit, again, to the disbenefit of the large incumbents."

"As we talked about, the remote market share is structurally always going to be lower than the land-based. It's expensive, but it's simple to grow a large market share in land-based: you open a lot of units, and/or you buy a lot of units. In online, there isn't an easy way of building up your market share because it is incredibly competitive."

"Remote operators also have some huge inbuilt advantages, which is something that I think the retail sector still hasn't got its head around. This is simply in terms of being able to take decisions quickly and having a much more flexible supply chain, and also being able to take money from more jurisdictions in a more relaxed manner than some more heavily regulated, land-based peers. This means that the retail operators have to create a remote product that's every bit as good as the remote only product if they're going to compete at all, which is hugely expensive and is going to start driving up the costs of the remote sector."

"It's our view at Regulus that omni-channel is not the good thing that everyone is talking about. It's certainly not the time to start feeling sorry for remote only operators who may have been expecting a lot of online market share growth from retail businesses. It's a defensive move designed to protect against channel shift, which is being talked about as a very positive move. Overall, the costs of competition within the remote market are, by necessity, going to grow because there's an awful lot of investment going into remote capability from retail businesses. The problem is that isn't necessarily going to grow demand. It is going to grow competition, which means the remote only operators have got to join in this arms race and start improving their product and infrastructure to make sure that the spend they're getting justifies their higher cost per acquisition and/or lower spend created by the customer reach of the retail environment. All that means is that if the awful lot of remote investment (cost increases) which is going on at the moment is simply being deployed around competition, which it is, then it won't increase demand. And if it doesn't increase demand, there's a lot less profit in the system, which has also come at a time when UK Point of Consumption taxes have now come through. It's our view that this is the beginning of a very difficult cycle for UK facing remote operators as competition increases, but not in a way that's designed to drive demand but instead to try to take market share off other operators. If that's the case, the big winner is the customer; the big losers are many operators."

Predicting Customer Behaviour with Data Analytics

Martina King and David Excell, Featurespace

Martina King is the CEO at Featurespace, the world-leader- in Adaptive Behavioural Analytics. Martina was formerly Managing Director of augmented reality company Aurasma, and has an extensive career in media technology. Her previous leadership roles include Managing Director of Capital Radio, where she doubled revenues as Sales Director and successfully defended the radio station's number one position in London. Martina was also Managing Director for Europe at Yahoo!, where she rebuilt the UK and Ireland business after the 'dot com' collapse and subsequently led the rebuilding of Yahoo!'s European division. Martina is also non-executive director of Cineworld and Debenhams.

David is Co-founder and CTO of Featurespace. He has over seventeen years of experience transferring technology into practical business applications, and under his leadership Featurespace has grown from a concept to a commercial success with many blue-chip customers. He obtained a first-class honours degree in Engineering and IT from the Australian National University before studying towards a PhD at Cambridge University. David has been awarded more than 11 prizes and scholarships for his academic and commercial achievements, including the 2011 ITC Enterprise Award for Young Entrepreneur.

Ms King introduced Featurespace as a machine learning tool which uses data analytics to monitor and predict individual customer behaviour in real-time. She explained that the company began life as a consultancy spun-out of Cambridge University's Engineering Department and employed behavioural understanding methods for a variety of industries, ranging from financial services to insurance. Featurespace was founded in 2005 by David Excell and Prof. Bill Fitzgerald and in 2008 was approached by Betfair to help them continue to grow their customer base without needing to grow their fraud team at the same rate. A dedicated fraud system was developed from Mr Excell's shed and with very positive results. Betfair renewed its contract with Featurespace for a further five years in 2013, and Featurespace has since grown to now provide services to 16 companies in the gaming sector alone.

"We've been involved in a number of very interesting projects over the years", Ms King enthused. "One example was an invitation to investigate a case of game manipulation, in which we found that the probability of the player getting a certain result was in fact 12,800 times more unlikely than the odds of winning the jackpot on the UK National Lottery seven times in a row. That evidence is now part of the ensuing court case to ensure that justice is done on behalf of the gaming sector."

Ms King continued in describing what she termed "probably the most important piece of work we've been involved in recently". Here, she explained, Featurespace was chosen by the Responsible Gambling Trust to examine whether it is possible to identify players with addictive tendencies, to distinguish between harmful and non-harmful gaming machine play and, if so, what measures might limit harmful play without impacting those who do not exhibit harmful behaviours. Featurespace found that it was indeed possible to identify markers of harm, with the results from that study now published and available on the Responsible Gambling Trust website http://www.responsiblegamblingtrust.org.uk/Research-Publications.

Ms King then introduced the Co-founder of Featurespace, David Excell, to demonstrate to the Summit how the technology works.

"One of the first things we need to ask before attempting to understand this technology is what behaviour is and then what data do we need access to,

KPMG
cutting through complexity


Martina King

"If we can get the right amounts of the data we want to track, and make them come to life, we can describe and distinguish between lots of different types of behaviours."


David Excell

in order to predict what an individual's future behaviour is likely to be", opened Mr Excell. "We then need to look at how we apply this to an online or business environment and what behaviours we're interested in within that context. Does our customer, for example, enjoy our service? Is the customer going to come back and continue to enjoy the service? Are they going to recommend our service to other customers? Are they going to go onto social media and blog negatively?"

Typically, Mr Excell explained, a business will collect data around the financial information they need in order to discern the location of incoming and outgoing funds, profit and loss figures and whether or not systems need to be changed around those. To then understand those figures, the business will need to understand 'richer' information about their customers, such as how they were acquired, where they registered, which products or services they preferred, how they arrived at that point, whether their experience was a positive one, or whether the depositing process was convenient. "All of this information gives us very rich information as to the behaviour of the customer and the experience they have when interacting with the product."

"So, that's the type of data that we need. How do we then go forward and use it in an environment which facilitates predictions about what the customer is going to do? As people, we're very good at spotting the behavioural characteristics of individuals, even strangers. We can use posture to discern their mood and we can tell if they're lost based on whether they seem to be wandering around. The challenge comes with teaching these very human concepts to a computer system."

"When researching for my PhD I was given access to data relating to 180 people walking on a treadmill. The task was to describe or uncover the different types of data that existed in this scenario and which would be pertinent when describing the characteristics of an individual interacting in that environment. By identifying and applying these data points, we were able to discern characteristically masculine and feminine traits which our subconscious brain could then use to assume differences in people without needing to, say, see their face. If we can get the right amounts of the data we want to track, and make them come to life, we can describe and distinguish between lots of different types of behaviours."

Mr Excell explained that, typically, when analysing data over time it is necessary to find a way of summarising and describing that. One of the more popular techniques used is to look at averages. Mr Excell used the example of two customers who each deposit an average of £20 per week over the course of four weeks. Using averages they appeared exactly the same, but upon closer inspection it was evident that the two behavioural stories were very different: one customer was very regular, depositing £20 every week, whereas the other was erratic, depositing an increasing amount every day over the course of four days. "This could mean he's experiencing problems or is a fraudster, and is in fact the sort of customer that the operator needs to pay a lot more attention to."

"I have a friend who wanted to play baseball but didn't have a bat. Amazon seemed like the right place to go so he went online. One of the things that really surprised him was the recommendation that came back when he tried to do so. I was intrigued, so I logged in myself and found the baseball bat that Matt was going to buy. Then I scrolled down to the recommendations and was slightly surprised to be recommended a ski mask, rope, knife, and pepper spray. Now, this may be a typical average but it isn't something that I would necessarily buy. This is the danger of averages; if you treat your customers as if they're all the same you compromise the individual's experience."

"So, what is this technology, how does it work and how is it deployed? Put simply, it's an engine; a complex piece of engineering that serves the single purpose to process data, understand that data and deliver results back to your business. It's a piece of engineering that does its job. Known as 'ARIC™', it combines data science with a modern software engineering platform."

"ARIC stands for Adaptive, Real-time, Individual, Change-identification. Each of these terms describes something unique about our software. Adaptive describes the fact that ARIC models self-learn as new types of fraud occur, which means zero model degradation. Real-time refers to the fact that it can spot anomalies the moment they occur. This means there is no need to create new business rules to combat fraud, manage risk, identify suspicious transactions and flag them before they are actually processed. We don't just do this across the entire customer base but also on an individual profile basis. We learn the nuances that describe one customer over another and we know that no two customers are exactly the same, so we don't want our analytics to be exactly the same. This enables us to accept more genuine customers and optimise treatment and their experiences. Most importantly, we understand change. We understand the nuances of when our customers start changing their normal behaviour. These nuances are the most important feature of understanding whether a change is significant of a risk that you want to interact with, or an opportunity that you want to grow. The system is scalable, can be fully integrated with existing processes, and is integratable and versatile."

"So how does this work in practice? Let's take a casino environment. Typically, one of the first things a new customer wants to do is fund their account, which means a whole series of activities. The next thing they're likely to do is stake, so they'll go through a series of staking activities. Now, depending on whether or not they win or lose, they'll then go on to other activities. If they win, or win a certain amount, they go on to withdraw, with the chance that they'll return or come back. They may also go onto another game to see if they also have a chance there. They might stake too much and decide to self exclude. What we can do is track a customer all the way through these decision points to understand, say, how many bets they'll place, what the balance is, what their win ratio has been, all the way through to then be able to say how the customer is transacting through this journey and what their next likely decision is going to be."

"One of our mobile customers came to us with the challenge of predicting when a customer was going to withdraw from their wallet – and was astonished with the results. They were able to use our data to decide that if a customer was going to withdraw, they would give them the opportunity to try another game and keep them for slightly longer."

Ms King then returned to the stage to discuss further applications for the ARIC™ platform, and its success rates. She reminded the floor that Featurespace are able to follow a customer in real time, compare individual patterns of behaviour, compare that person against themselves and compare that person against the whole global population. "Because we're able to understand the individual digital fingerprint of every single player, we're able to take a very unique approach to problems that have existed for a very long time both in the online and offline worlds."

"If you can understand who a person is and what their normal patterns of play look like, you're in a position to use the anomaly spotting technology to identify an account takeover, hack or attack, for example. Many fraud companies will counter attacks by building walls – they'll try to guess what all the different types of fraud attacks are and build rules against them. What we do is to take a totally different approach. Instead of building walls, we said 'if you genuinely know your customer, and you know the behaviour patterns of your customer, you will be able to understand whether it's them or not and therefore be able to flag a fraud attack before it happens."

"As we mentioned earlier, we're also working with the Responsible Gambling Trust and took the data of five operators – which is ten billion pieces of data – to analyse. Even before we worked with this data, however, one of the things we thought would be really fascinating to see was whether it would be possible to build a health check to separate out those players who are playing healthily. Let's say we're watching players, particularly high value players like professional footballers. If you put up a blunt rule that says we're going to permit people to only spend a certain amount of money, that isn't necessarily going to do anything for the enjoyment of the player if they're high net worth. But by following and understanding the pattern of play of that person as an individual, we can start to see if they're chasing their winnings, start to see unhealthy behaviour, and send perhaps an alert or flag pertaining to that individual. The system is now built, it is deployed, it is working such that we're now able to identify a group of players and say 'we know that x percentage of players within that group is playing within their boundaries, these are the players on our watch list, and these are the players for whom intervention is necessary'. The analytics can feed directly into a CRM system and enable you to manage that intervention."

"Of course, there's another part of the project at the moment, which is to identify which of those intervention techniques are most effective. The other thing that's really helpful is you're not just taking a sample size which is made up solely of self-excluders. As we've heard, one of the things that people would like to do is try to pre-empt customers going into problem areas. So, again, we're using different behavioural patterns to make our predictions."

"Yesterday we also heard that the marketing expenditure, as far as the online industry was concerned, equates to about 25% and 30% of revenue simply to get the punters in the first place. We often find, however, that whereas a lot is being done to attract customers, very little is being done on retention. This is where we can employ a new technological approach which enables us to follow these customers and start to predict the moment they're going to leave you. From that moment in time, we're then able to determine what sort of incentive we're going to put in place or what type of conversation we need to have on an individual basis. In one particular instance, working with a large operator, we were able to see a massive uplift in monthly revenues and, more importantly, a 43% increase in revenues from those extra players we were able to retain. The gaming sector really is ahead of the curve in embracing a world-leading machine learning approach to build healthy relationships with your players, comply with responsible gambling legislation and detect financial crime, and for that Featurespace would like to thank you."

KPMG
cutting through complexity

Closing Words

Micky Swindale

Managing Director,
KPMG Gibraltar

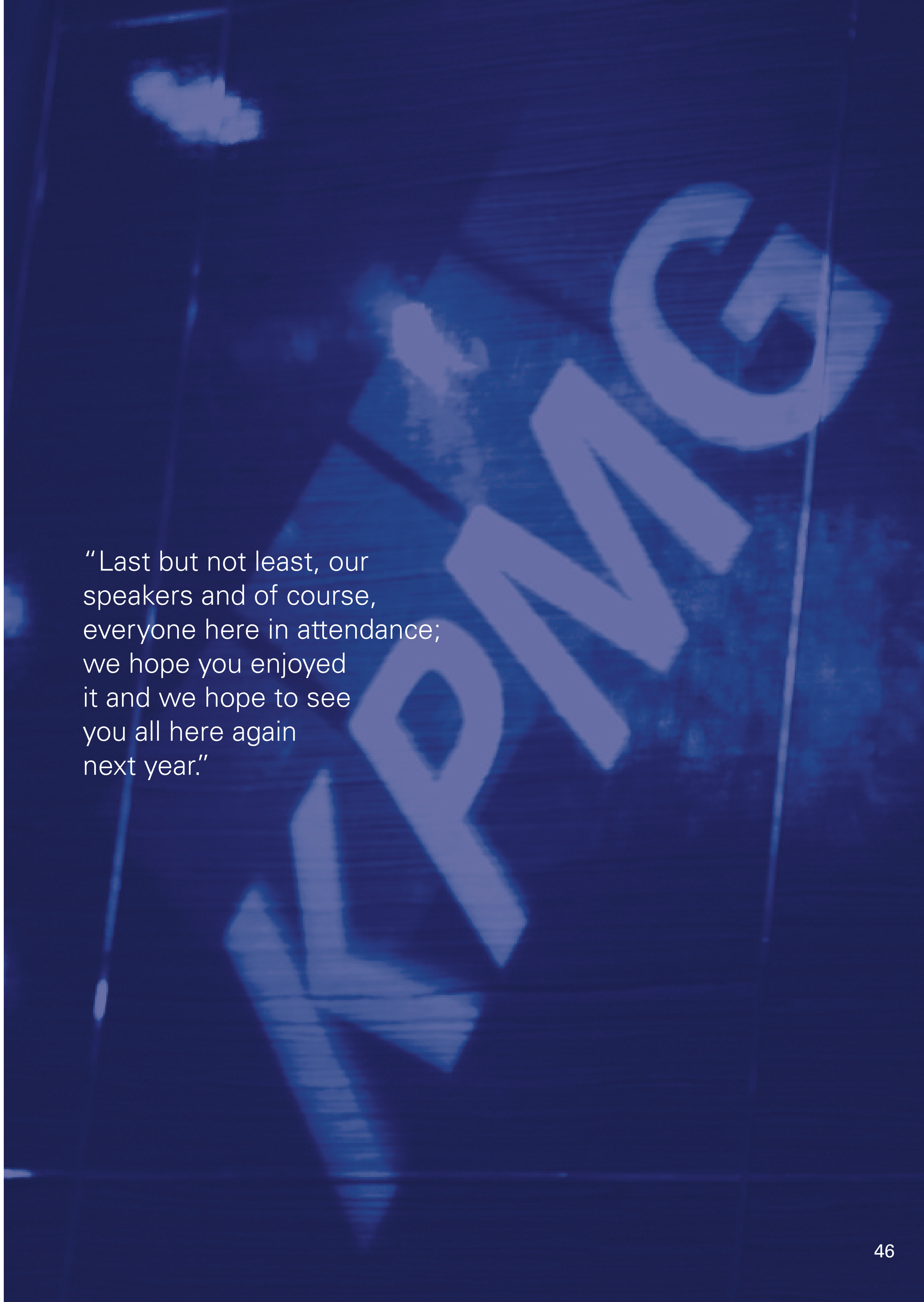
"After a long two days full of information and fascinating discussion, I would just like to finish off with one or two thank yous", Ms Swindale said in closing KPMG's fifth eSummit instalment in Gibraltar.

"Ian and his team at Sound Reinforcement Systems, who helped us with the technical installations both here and at the Gala Dinner in St Michael's Cave last night; we really don't know how we would do this without you. Ashgrove Marketing, who are based in the Isle of Man but who have also done some amazing work for us here in Gibraltar at various venues, in various ways, faced with various challenges over the years – thank you."

"This year we have a huge thank you to make to the Government of Gibraltar – they have supported the summit since its inception in 2010, with Ministers and the Regulator as speakers – but in 2015 they really went the distance with last night's gala dinner – I am particularly grateful to Phill Brear and Paul Astengo, who have been very hands-on."

"Our most sincere gratitude to our sponsors Continent 8 Technologies, Isolas, Gibtelecom, W2 Global Data, Intelligent ID, World Trade Center Gibraltar, Hassans, and Ramparts. Thank you also to our media partners iGaming Business and Gambling Insider and a very special thank you to the International Masters of Gaming Law."

"Last but not least, our speakers and of course, everyone here in attendance; we hope you enjoyed it and we hope to see you all here again next year."



"Last but not least, our speakers and of course, everyone here in attendance; we hope you enjoyed it and we hope to see you all here again next year."

KPMG

cutting through complexity

cutting through complexity

KPMG Limited
Tel +350 200 48600
www.kpmg.gi