

British gambling regulation is changing - are you getting ready?

As Great Britain continues its slow progress towards a new gaming regulatory environment, we continue to receive questions from our clients and other stakeholders within the industry asking how best to prepare for the new regime. Clients want to know how they can share with the UK Gambling Commission (the "**Commission**") the lessons learned during licensing procedures in other jurisdictions.

We hope for a regime that is balanced and workable, whilst always operating in observance of the stated licensing objectives of the Gambling Act 2005 (the "**Act**"). It is important to remember these objectives, as they form the basis of many of the Commission's policy positions.

The British legislature set out its stall in section 1 of the Act when passing it in 2005; the purpose of gambling regulation is:

- to prevent gambling from being a source of criminal gain;
- ensuring gambling is fair and open;
- protect minors and other vulnerable people from harm and exploitation.

It seems to have come as a genuine surprise to some that the overwhelming majority of gambling regulations in Great Britain are already in place. Whilst they may need augmentation or adaptation to accommodate the new point-of-consumption ("**PoC**") system, wholesale changes are not necessarily expected.

It is with this backdrop that the recent commencement of a consultation by the Commission on potential updates to the regulatory framework should be viewed. The Commission has decided to consult the industry on a number of issues that are pertinent to the way remote gambling operators and their supplies are regulated. The consultation does deal with a handful of issues only relevant to the land-based industry, but mainly on issues pertinent to remote operators.

Whilst operators and suppliers may lament on how other jurisdictions have been largely unwilling to interact with them during the legislative process, the Commission have made it very clear they wish to preside over a workable and commercially viable market, but one which balances this with the licensing objectives.

Any stakeholder interested in the British market needs to read these consultation documents and, where appropriate, respond to them.

There are a number of areas that the Commission freely admits are not as well understood from a regulatory point of view as they might be and it is the experience that operators and suppliers have within other regulated markets which the Commission now wishes to tap into.

Below we set out the key areas that we think are worthy of consideration by the stakeholders and where we feel the debate is likely to be keenest. But first, a reminder of the current system, unfamiliar to so many offshore operators who have never had the need to consider it in any detail.

1. Background to the current British regulatory environment

Upon issuance of a licence by the Commission, a remote gambling operator is subject to the Licence Conditions and Codes of Practice ("**LCCP**"). The LCCP is a fundamental part of the regulatory framework within the United Kingdom and is central to the pursuit by the Commission of the licensing objectives.

Conceptually, the Commission sees its role as one of a guide, providing information and infrastructure to the industry to allow it to operate its businesses within the confines set by the Act and the corresponding provisions presided over by the Commission. As such, the LCCP is designed to be a non-exhaustive framework to provide the industry with the tools to develop what the Commission calls "good practice". However, the obvious consequence of deciding to provide a non-exhaustive list of requirements which themselves are open to interpretation, is a lack of clarity which, itself, can be counterproductive.

The Commission has commenced two consultations - on looking at the LCCP, the other looking at the protection of customer funds and proposals for further relevant to relevant licensing conditions. We consider both consultations here.

2. The LCCP Consultation

The Commission is asking the industry for its views in a number of areas.

2.1 Advertising and marketing of free bets and bonuses

The advertising of gambling services within the UK (and indeed a number of other jurisdictions) continues to be a source of negativity in the media. The Commission is aware that the UK advertising regulator, the Advertising Standards Authority, has received an increasing number of complaints in the last few years and as a response to that, the Commission is working in a collaboration with a number of interested regulators to consider this issue in more detail and to determine whether or not further action/restrictions need to be put in place. A further consultation, specifically regarding this subject, will be had at a later date. In the meantime, the Commission is asking the industry what such a review should consider.

2.2 Proposed amendments to information sharing

The LCCP lists, in some detail, the types of information that must be shared with the Commission by licensees in relatively quick order following their occurrence. Such "key events" range from obvious matters relating to a licensee's solvency through to details of new URLs used within the business.

The consultation considers the potential introduction of a number of new information sharing requirements, including:

- 2.2.1 information regarding any investment in a licensee that is not by way of subscription of shares, for example any loan instruments;
- 2.2.2 information on any lending to the operators by any person who is not regulated by the Financial Conduct Authority or any equivalent financial regulator; or

2.2.3 any material change in the licensee's banking arrangements.

For each of the above, sufficient information needs to be given to the regulator for them to be able to assess the "suitability" of any arrangements; although the consultation document does not make it entirely clear as to what the Commission would do if they considered any aspects of such arrangements to be unsuitable.

Operators and suppliers are also required to inform the Commission if they or any of their group companies make an application to any gaming regulator in any other jurisdiction. They must also notify the Commission of the outcome of such an application and, in the case of any withdrawal or refusal, the reasons for such withdrawal or refusal. So, for the first time, many multi-national gaming technology suppliers, that may have a myriad of licences and authorisations around the world, will have to inform the Commission if they are required to make any additional applications or if there is any investigations into such activities in any other parts of the world.

Whilst it is not exactly unusual for a regulator to require an understanding of its licensee's wider regulatory activities, one wonders if the Commission's on-going receipt of significantly more information is proportionate.

2.3 Changes affecting the remote gambling industry, specifically

Operators who seek to transact with or advertise to British consumers will be required to obtain an operating licence from the Commission. It is envisaged the regime under which such requirements bite could be implemented as early as April 2014, with the corresponding tax burden coming into play by the end of 2014.

The Commission acknowledges that its experience regulating of remote gambling is a work-in-progress, on the basis as it only regulates a small proportion of Great Britain-facing gambling operators. Moving to the PoC regime, the Commission have determined a number of amendments may be required to existing regulations.

2.4 The location of remote gambling equipment

Any current Commission licence-holder must agree with the Commission where it will locate its "remote gambling equipment". This equipment is also referred to as "key equipment" which is, in effect, any equipment which fulfils a function which the Commission consider to be pertinent to its pursuit of the licensing objectives. This includes equipment handling result generation, bet capture, bet settlement, virtual event presentation. It also includes the storage of gambling transaction records insofar as such records are used to market to players during live sessions.

The Commission has allowed operators to locate certain remote gambling equipment outside Great Britain, but always on the condition that such location is fully known to the Commission and that is satisfied as to the integrity of the environment.

Currently, at least one piece of remote gambling equipment needs to be in Britain; the new legislation will remove that requirement. As such, it is accepted by the Commission that it will be regulating remote gambling operators that may have no presence whatsoever within Britain. The Commission is willing to work with this, but on the basis such licensees inform the Commission if they move remote gambling equipment from one jurisdiction to another.

The Commission needs to have access to such equipment as and when it feels it is necessary for "*determining the suitability or compliance with a condition of that operator*".

2.5 Regulation of remote gambling software providers

We have been involved in a number of instances in the past advising remote gambling software providers how to set their businesses up in such a way that it does not move their activities within the British regulatory net. One of the challenges facing the Commission is how to ensure that it can enforce its regulatory regime against gambling software suppliers who continue to have no nexus with the jurisdiction whatsoever.

The Commission has decided to implement a provision which requires any holders of remote gambling operating licences to source their "gambling software" from Commission-licensed gambling software businesses. It is likely that this will achieve its purpose as, in our experience, operator will ensure that the gambling software suppliers that it contracts with holds the relevant licences, not only to ensure that they are dealing with people of substance, but also to ensure that the operator is justifiable in its belief that it is taking the benefit of software which itself is subject to the relevant technical standards and regulatory oversight.

We do feel the Commission could take this opportunity to go further than it has previously done in providing guidance on what constitutes "*gambling software*", an increasingly nebulous concept in today's rapidly changing technology environment.

2.6 Regulation of poker networks

The Commission has undertaken a considerable amount of pre-consultation discussion with the industry, particularly large gambling operators and their software suppliers, to understand more about the dynamics of poker networks; particularly, to determine how such activity should be regulated in the new PoC regime.

The Commission's stance is based on the premise that B2B network operators are actually hosting the gambling activity in certain circumstances whilst relying on the B2C operators they contract with to undertake player verification, registration, banking and generally handle the day-to-day relationship with the player.

The Commission has rightly noted that, when one breaks down a poker transaction into its component parts, a number of the technical activities actually fall on the B2B network operator's side of the fence. Perhaps rather disappointingly, the Commission "*does not consider it appropriate to define which obligations*" would apply to these entities as they consider them likely to vary between them. One does wonder whether the Commission would be better placed to be more helpful in these circumstances to ensure that no regulatory obligations fall between the gaps when such relationships between B2B and B2C operators are put together take place.

2.7 Participation by British players in networks

The Commission has voiced its concerns where British consumers participate in networks in such a way that could place them in a vulnerable position. The Commission is proposing to introduce a condition that requires B2B network operators to have "*policies and procedures in place that are designed to ensure British players participate in the B2B network via a commission-licensed operator*".

Clearly, this assists with enforcing the regime, minimising the risk of British consumers playing with unlicensed B2C operators who may not provide a robust set of protections for the player. The Commission is, therefore, commandeering network providers to help them achieve this.

There has been considerable debate around what constitutes a "*British player*" and the Commission's view is that this would be somebody who is physically located in Britain when the gambling facilities are used, rather than being determined by the address of the relevant player.

Furthermore, the Commission is going to require B2B network operators to put in place "*appropriate information sharing agreements*" with their B2C operators to ensure that they are in a position to discharge their regulatory responsibilities of reporting potential criminal behaviour to the Commission, resolve customer complaints and to assist in the detection of, and interaction with, vulnerable players.

2.8 Pooling British and non-British player liquidity

The Commission is focusing, particularly, on P2P poker networks in which players compete directly against one another. As we all know, such networks are prone to collusion and other types of fraudulent activity, despite the lengths that B2B network operators go to discourage such activity. The Commission wishes to avoid a situation where British consumers are accessing networks where they go up against players who themselves join that network through B2C operators that are subject to only "light-touch" regulation, thereby threatening the integrity of the network as a whole. In order to deal with this risk, the Commission is proposing to impose a condition on B2B poker network providers that will require them, when networking British players with players that have entered via a non-Commission licensed operator, to have effective measures in place in a number of areas.

Such B2B network operators must ensure that any operators who participate in their networks yet are regulated by the Commission:

- hold the appropriate licences in the country in which they are based;
- are "*suitable*", having conducted due diligence enquiries; and
- have effective measures in place to deal with anti-money laundering issues.

There is clearly some way to go in the development of these regulations; the Commission will certainly need to be quite prescriptive about what "*suitability*" requirements need to be met.

2.9 Identification of individual customers

The Commission remains concerned that not enough is being done by the industry to ensure that players who open more than one account cannot do so in such a way that jeopardises the licensing objective to protect the vulnerable. Duties are imposed on operators to interact, offer self-exclusion tools and other assistance. It follows that that the implementation of certain player protections facilities may not be triggered in a multi-account scenario as they would be if the player had only one account.

As such, the Commission intends to strengthen the current provisions to ensure that operators must link customer accounts' activities and also "*take all reasonable steps*" to link to any accounts held with group companies to ensure that players are afforded an adequate level of protection across the entire estate of that particular organisation.

2.10 The consultation also considers:

- the obligations on operators and suppliers to co-operate with the Commission in ensuring that they are aware of any issues that may lead to have a material impact on the licensee's business or the ability for it to conduct its licence activities compliantly;
- the obligation of operators not only to ensure that they have terms and conditions that are compliant with the relevant consumer regulations, but also that they comply with those terms;
- proposed, fundamental changes in the way in which player disputes can be handled, notably with the requirement that the services of any alternative dispute resolution process must be free of charge to the customer;
- an explicit requirement that the individual fulfilling the role of a regulatory compliance officer should not be an individual who also conducts "*specified management functions*". An example is given which would include the inappropriateness of a compliance manager also carrying out the role of marketing, because of the potential conflict of interest that would arise;
- the (rather obvious) requirement that where the operator outsources certain elements of its functions to third parties, that it remains fully responsible for all of its compliance requirements.

3. The consultation on holding of player funds

Following on from the [Gambling Commission's announcement back in February](#), the consultation regarding the protection of player funds has now been [published](#), albeit later than anticipated. The consultation seeks to the industry's views on potential changes to the way in which operators protect customer funds against insolvency events or fraud, whilst also seeking to provide greater transparency for customers regarding the safety of their money.

There is currently no obligation on British-licensed operators to separate customer funds from corporate funds. With the events of the Full Tilt debacle clearly at the forefront of the Commission's mind, it proposes that a change, at least implementing greater transparency, may be needed. Six options were put forward for consultation by the Commission; the option to do nothing is one which the Commission clearly does not entertain:

1. Segregated accounts - creating a distinct account for customer funds so that they are not co-mingled with company funds.
2. *Quistclose* trust - a concept under English law whereby funds are held beneficially on trust for the benefit of customers and if such funds are not use for the purpose of betting and gaming, they must be returned to the customer (therefore not available for creditors in an insolvency event).

3. Insurance against insolvency - high-cost option and unlikely to protect the full liability to customers.
4. Independent trust account - a trust account is created and is managed by an independent trustee, thereby protecting from insolvency and even fraudulent activity by the operator to some extent. Clearly the most robust option from the Commission's point of view given it could put reporting requirements on the trustee but it is also a relatively high-cost option.
5. Reserve held by the Commission - this would enable the Commission to offset any risks to customer funds. However, when this method was used previously (for land-based casinos), it proved costly for the industry when compared to the benefit for customers.
6. Rules for specific gambling products - online poker is the main concern, given players sometimes leave large amounts on deposit with operators.

The preferred option for the Commission is to implement a minimum level of protection and require operators to create separate bank accounts in which to hold customer funds. Not only will the segregation of funds assist from an accounting perspective but it is also relatively low cost and not too onerous for operators (even small scale operators). However, the Commission's take is that simply segregating customer funds will not be sufficient if such funds are still vulnerable from a fraud or insolvency perspective and the customer has not been made fully aware of this fact.

More often than not, details of what happens to customer funds in the event of insolvency is tucked away amongst pages and pages of terms and conditions, which the vast majority of punters don't read. Although the insolvency of the largest UK operators seems like a virtual impossibility, the Commission feels that customers should at least be able to make an informed decision about the risks of depositing with gambling operators. To that end, the Commission have proposed a rating system whereby operators must assess their own policies based on guidelines produced by the Commission and, with supporting evidence, grade their protection of player funds on a sliding scale from basic to high; basic being segregated accounts, medium as *Quistclose* trust / insurance / reserve, and high as an independent trust account.

The Commission, when discussing this topic in February, commented that they were keen not to create another "white-list" concept by introducing a rating system for player protection; meaning that operators can only bank with certain institutions or in certain jurisdictions to be able to satisfy the Commission's guidelines. However, by creating a rating system, it is thought that the Commission is hoping that operators' natural competitiveness encourages them all to adhere to the higher levels of protection. It remains to be seen if some operators feel that their brand, coupled with customer loyalty, is enough to trump the need for the customer to seek out the most secure place for his/her funds.

Other points the Commission want to consult on include:

- The impact the proposed amendments will have on small-scale operators, particularly in terms of cost.
- When to reconcile customer funds and whether or not this should be a condition imposed by the Commission.
- Providing the same level of customer funds protection across common or combined wallets.

- Designating banks or jurisdictions where customer funds can be held.
- The monitoring and reporting requirements that operators must adhere to for protection of customer funds.

NEXT STEPS

The amended LCCP will come into force in 2014. The majority of the changes are expected, at the earliest, in April.

Now is the opportunity for the industry, and particularly those that have experience of operating in other regulated markets to step up and share their experiences.

The responses to the consultations are sought by Wednesday, 4 December.

We will be happy to discuss any of our clients' views on any of the issues raised in these consultations.

Links

[The Gambling Act 2005](#)

[Gambling \(Licensing and Advertising\) Bill](#)

The current [Licensing Codes and Conditions of Practice](#)

The [LCCP](#) consultation documents.

The [player funds](#) consultation documents.