Oaklins

Licensed to play: navigating the regulatory landscape

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In this edition of Spot On, we will be covering the latest regulatory developments across the US and Europe. We will also look at the impact these developments are having on the operations of market players and the associated competitive dynamics, as well as provide an update on the recent M&A landscape.

REGULATION

Since the inception of the online gambling industry in the mid-'90s, perhaps the most notable driver of change in the operating landscape, alongside technological developments, has been the ever-evolving regulatory environment.

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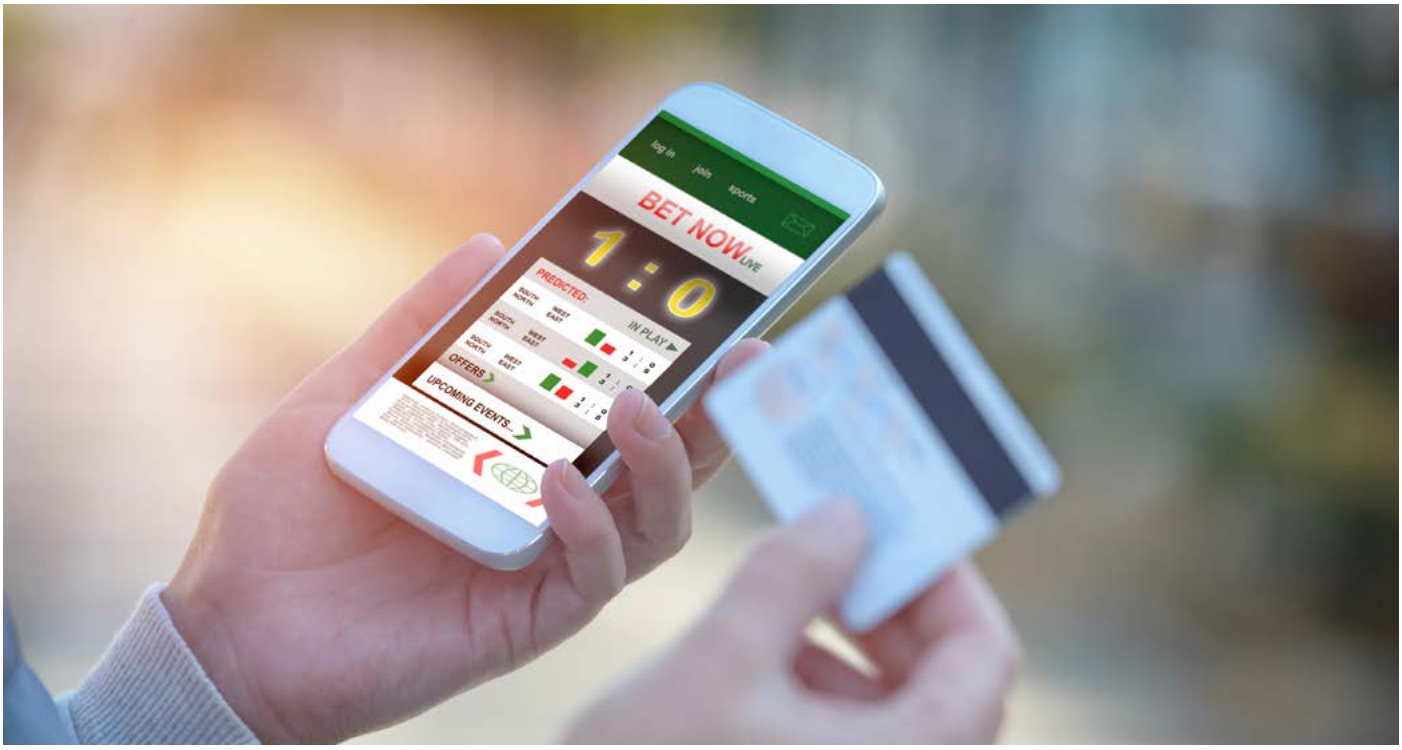


Regulation

While most jurisdictions across the globe at some point have prohibited the offering of online gambling services to their citizens, or had pre-existing state monopolies effectively illegalizing such activities, the ease with which operators could circumvent local laws contributed to the industry's massive growth over the years. After all, this whole industry started during the early stages of mass Internet adoption, creating technological challenges to enforcement.

Rather than continuing to fight a losing battle, as they have for the last 20 years or so, most regulators of late have realized that allowing online gambling under regulated forms enables them to collect additional tax revenues and provide increased support and player protection. As such, we are amid an ongoing re-regulation wave. Several jurisdictions have implemented licensing systems, granting licensed operators the legal right to offer online gambling services to consumers while shutting out unlicensed ones, and more are in the process of doing so.

REGULATION IN THE US

Online gambling in the US is regulated on a federal level, primarily in the form of the Interstate Wire Act (often referred to as the Federal Wire Act or simply the Wire Act) of 1961. The Wire Act, in effect, prohibits all forms of interstate or foreign betting or wagering that utilize telecommunications to facilitate transactions. Coming into force during a time when the Internet did not exist, the act implies that individual states are allowed to regulate online gambling within their respective jurisdictions. Such state legislation would naturally have to be brought forward and approved—which did not happen until 2011, when New Jersey legalized online wagering on poker, casino games and slots. The same year, the US Department of Justice (DoJ) issued a formal statement on the Wire Act, concluding that wagering that does not pertain to a sporting event or contest falls outside the reach of the regulation. While most states still had local regulation prohibiting online gambling, the DoJ opinion served as a key step toward unlocking the US market, until a new opinion, dated 2 November 2018, reversed the 2011 equivalent by declaring that the Wire Act's prohibitions are applicable to all forms of online gambling, not only sports betting. As market players had relied upon the DoJ's original dictum—investing significant time, effort and monetary means to position themselves for an opening market—operators and states alike have been pushing for the DoJ to withdraw its opinion. The level of uncertainty remains high, as several state attorneys have filed lawsuits or requests for clarification regarding the November opinion. As of today, the only certainty is that uncertainty will continue to surround the US online gambling market.

At the state level, however, more and more states are actively introducing bills to regulate various forms of online gambling—in 2019 alone, some 20 states have introduced such proposals.

As a consequence of the Wire Act, most pursue licensing models in which only state lotteries and/or licensed, land-based casinos are allowed to offer remote gambling services so as to ensure that the offered services are confined to within state borders, thus ensuring compliance with the Wire Act. That said, outside operators may eventually be allowed licenses should the DoJ reverse its opinion. This is the case with the state of New Jersey, which, as mentioned, was the first to introduce legalization.

REGULATION IN EUROPE

The European regulatory landscape is significantly more advanced and straightforward than in the US, with each country in charge of its own regulation. Malta pioneered the European regulatory landscape by being the first country to implement an online gambling licensing system in 2001 and many others have since followed suit, particularly in the last decade. While many have, or are in the process of, implementing such legal frameworks, it is important to remember that these are seldom static in nature but rather amended and tweaked continuously. To this end, we provide an update on the current developments within key European online gambling markets.

UK

British operators will soon have to deal with a tax hike, up from 15% of gross gambling revenue (GGR) to 21%. The raise is a measure to counteract the loss of governmental tax income following the April 2019 implementation of reduced maximum allowable stakes on fixed odds betting terminals (FOBTs). For operators of FOBTs who also operate online, it is a double whammy.

GERMANY

In Europe, Germany has the regulatory landscape most similar to the US in that the landscape is primarily regulated by the 16 individual states, though there is also a federal, interstate treaty prohibiting online gambling with the exception of sports betting. In March 2019 the federal states approved a third iteration of the treaty, a short extension of the ongoing experiment, whereby a temporary sports-betting licensing system will be in effect from 1 January 2020 until 30 June 2021. Following the expiration, the widespread expectation is for gambling regulation to see a complete overhaul in favor of a nationwide gambling licensing system. According to the treaty, a 5% taxation will be imposed on turnover and in-play betting will be prohibited. Moreover, players will be allowed to spend a maximum of EUR 1,000 per month (US$1,125).

The state of Schleswig-Holstein will be permitted to continue its regulatory regime, introduced in 2011, until 30 June 2021. Contrary to the State Treaty, its regulatory framework does not put a restriction on gambling verticals and it is seen as a testing ground for nationwide legislation.

SWITZERLAND

A licensing system was introduced in January this year. Initially, licenses will only be available to existing Swiss land-based casino operators for the first six years, i.e. until the end of 2024. From 2025 and onwards, international operators will be able to apply for licenses in the country.

NETHERLANDS

The Dutch gambling authority, KSA, has long been attempting to fine gambling companies targeting Dutch players, but has experienced significant difficulties in doing so, as the regulatory framework has not granted it enough power to effectively monitor and manage the space. Almost four years ago, the lower house of the Dutch Parliament approved the Remote Gambling Bill. Since then, continuous efforts have been made to have the bill approved by the Senate, which, much to the satisfaction of operators awaiting a breakthrough, finally happened in February. The first licenses are expected to be issued during mid-2020, with international operators being eligible for a license.

The regulatory framework will impose rules on operators to adopt measures aimed at minimizing the risk of gambling addiction and maximizing player protection. As in the case of Sweden, operators will be required to register with a centralized self-exclusion program, whereby problem gamblers will have the opportunity to ban themselves from gambling sites for a certain period of time.

SWEDEN

In January 2019, Sweden introduced a licensing system breaking up the former state monopoly. (See the interview with Maria McDonald from Nordic Gambling on page 4.)

Interview with Ario Mansoori, associate at Nordic Gambling

What are the main challenges ahead of the system coming into force in 2019? Are there any major differences with respect to other regulations in Europe?

The short time to re-regulate the market was due to the government's wish to push these changes through quickly. Spelinspektionen, Sweden's gaming regulator, has been under as much pressure as the operators. There have been some teething problems and challenges, both for operators and for authorities, and it was a challenge to have everything ready in time for 1 January 2019. At the same time, it is important to remember that these legislative changes were long overdue and even though Sweden in theory had a monopoly system in place before, it had, in practice, been outdated for years. From this perspective, it is very positive that the new legislation was finally put in place.

All in all, the gambling framework is not that different from other re-regulated jurisdictions in Europe. Both the product scope and the level of taxation are reasonable. What differs from other jurisdictions in Europe is how the government intends to protect the consumer from extensive gambling and the fact that only a welcome bonus (but no other financial incentive or rebate) may be offered to players. The intention is novel and aims to protect players from unrealistic bonus schemes. However, the provision risks creating the opposite effect. The risk is that players could shop around with different operators to receive new bonus offers instead of staying loyal with one operator and giving that operator the chance to follow the player's gambling pattern, detect signs of problem gambling and follow up accordingly.

What are the main challenges faced now, post-licensing?

Since the Gambling Act is a framework legislation, it is natural that there are areas where interpretation is needed from Spelinspektionen and/or where case law will develop.

At the moment, operators are experiencing uncertainties, in particular when interpreting the requirement that marketing shall be "moderate," and they find it difficult to know exactly what measures could constitute a bonus (where only welcome bonuses are permitted).

As is often the case in re-regulated markets, certain operators seem to struggle to make a profit—at least initially. This probably means that we will see consolidation in the market and that it is likely to start already in 2019.

In your experience, what has been the initial reaction to the legislation among licensed operators in Sweden?

The re-regulation is a success in that we have seen 67 operators receiving licenses in the competitive market (42 commercial online gambling and betting, 2 betting and 23 online commercial gambling licenses). It seems feasible to reach the target of 90% channelization within two years.

In the main, operators welcome the re-regulation and the opportunity to be able to receive licenses in Sweden. There are some very cumbersome parts of the license application and there is some technical development to be done, but most operators are trying to be as compliant as possible.

ARIO MANSOORI
ASSOCIATE
NORDIC GAMBLING

In the medium to long term, how do you see the regulation evolving, e.g. in light of the on-going discussion regarding the marketing of gambling products?

The regulation was inevitable as the market has been "gray" for many years, with foreign companies targeting Swedish consumers with online gambling websites. As such, the regulation is well received. However, there has been a lot of criticism related to the marketing of gambling products. Advertising on TV and in social media in particular have been met with criticism from the government, who have described both as unacceptable and unsustainable. The minister for public administration, Ardalan Shekarabi, has threatened tighter legal restrictions around advertising.

The Swedish Gambling Authority has said that one focus is match-fixing, and it could be that we will see restrictions related to live betting and/or betting on lower leagues.

Marketing: a new landscape is taking shape

GAMBLING ADVERTISING HAS BECOME AN INCREASINGLY DEBATED ISSUE OVER THE LAST YEAR, AS A WAVE OF STANDARDS AND RESTRICTIONS CONTINUES TO SWEEP OVER EUROPE.

A number of industry players, including giants Paddy Power Betfair and William Hill, have called for a clampdown on advertising over recent months, inviting the government to introduce guidelines for the protection of children.

UK

The Committee of Advertising Practice (CAP), responsible for writing and maintaining the UK advertising codes, has devised guidelines prohibiting online ads for gambling products targeting individuals likely to be aged under 18. The standards, which came into force on 1 April, cover all digital media, including social networks and other online platforms.

This comes a year after CAP, in April last year, rolled out a set of tougher general standards on gambling advertising, focusing on adverts with free bets and bonuses that appeal to problem gamblers. Unacceptable content includes animated characters, licensed characters from film or TV shows, sportspeople or celebrities with a particular appeal to children, as well as references to youth culture. Further, the standards prohibit the use in gambling ads of sportspeople, celebrities or other characters who are, or appear to be, under the age of 25.

The new standards relate specifically to advertising online, as data from the Advertising Standards Authority (ASA) has revealed, not surprisingly, a decline in children's exposure to gambling adverts on television.

In December, the UK's Industry Group for Responsible Gambling announced new rules, coming into force this summer, prohibiting betting adverts from five minutes before kickoff of a live sports event to five minutes after the end of such event. Adverts are also prohibited for non-live sports broadcasts airing before the 9:00 p.m. watershed.

Although widely praised, Labour Party deputy leader Tom Watson has said that the new developments are only a "first step" and that the industry must now take steps to reduce its online advertising, with recent studies showing that 80% of UK gambling operators' marketing spend is through online channels.

When working with influencers, operators should take influencers' appeal to under-18s into account. There is also a responsibility to ensure affiliates, or other third parties acting on the operator's behalf to publish or disseminate ads, comply with the CAP standards.

ITALY

Italy has become the first European country to impose a complete ban on gambling adverts. TV, radio and Internet promotions have all been halted since January, despite opposition from betting companies. Sports teams—including Lega Serie A football clubs, where over 50% have sponsorship deals with companies in the gambling sector in place—will also be barred from having gambling sponsors. Deputy premier Luigi Di Maio introduced the ban as part of the Dignity Decree (Decreto Dignità), aimed at curbing a dramatic rise in problem gambling in Italy.

BELGIUM

Similar to the UK, the Belgian government has announced a ban on betting advertising during live sports events. The ban—which, as in the case of the UK, comes into force this summer—will see a watershed set at 8:00 p.m. for online gambling advertising and prohibit adverts during live sports broadcasts 15 minutes before until 15 minutes after the event, according to a royal decree by the Council of Ministers. Moreover, celebrities and athletes will be legally barred from representing gambling companies. Restrictions on the types of channels allowed for online advertisements will also be put in place, with channels with a high proportion of underage viewers being blocked. This tightening of restrictions is accompanied by other shifts in Belgian law, perhaps most notably limits on weekly deposits and the sizes of bonuses and the banning of credit card deposits.

SPAIN

In Spain, a proposed agreement would severely restrict gambling advertising, promising to treat betting like tobacco. The proposal is not necessarily reassuring for gambling operators, as tobacco advertising is prohibited from appearing on all broadcast media, in domestic newspapers and magazines, outdoor signage, paid placements in TV or film, and all sponsorship of events, activities, individuals or organizations. Local media reported that María Montero, Minister of the Treasury, clarified that online gambling operators would be constrained to a "very limited" menu of advertising options, restricting ads to "environments where it does not harm consumption." Gambling ads would be banned from airing during broadcast periods in which children were likely to be watching or listening, and no ads would be permitted at sporting events. Further, celebrities and other public figures—including athletes—would be barred from participating in gambling marketing.

DENMARK

In January, Niels Folmann, CEO of state-owned Danske Licens Spil, told local media that the Danish government should follow the UK's lead and enact a "whistle-to-whistle" prohibition on gambling advertising during televised live sports events to limit the temptation among young and vulnerable gamblers. Folmann's proposal has already met the approval of the Danish People's Party (the main opposition party), the Socialist People's Party and the Danish Social Liberal Party, who are ready to introduce legislation to impose the ban should the gaming industry not act voluntarily.

SWEDEN

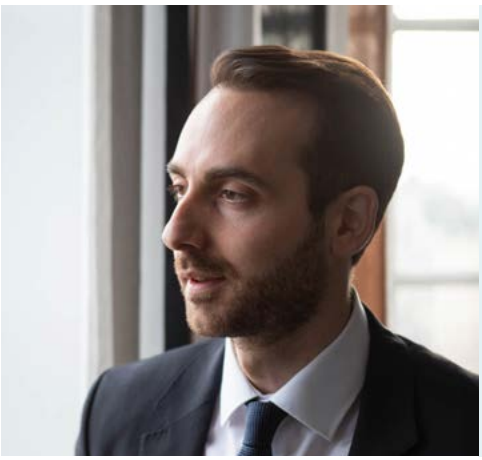
Svenska Spel, the Swedish state-owned gambling operator, has recently decided to stop all forms of advertising of all online casino products in the country for the rest of the year, in a bid to improve consumer protection amid growing pressure from the Swedish government. According to a statement delivered by Patrik Hofbauer, chief executive of the state-owned company, starting in April, it would be ceasing and desisting from all forms of online gambling advertising.

The effects of the new rules and proposals remain to be seen, but we believe that more regulations around the marketing of gambling products are to follow—specifically ones targeting online channels, which is the primary point of exposure for younger generations.

RIPPLE EFFECT

The pressure being exerted on operators with regard to the marketing of gambling across Europe—nowhere more so than in the UK—is forcing operators to fundamentally reconsider how they go about their activities. This includes their affiliate relationships, and some operators have already taken measures to take greater control of their affiliate networks. In September 2017, Sky Bet decided to end its own affiliate program, with 888 and GVC's Ladbrokes indicating intentions to scale back their activities in the area. Further, in September 2017 it was reported that Paddy Power Betfair had sent a letter to its affiliates, warning of a one-strike-and-you're-out rule over future violations.

Of course, some new markets will come with even stricter rules pertaining to affiliates. In New Jersey, affiliates working on a revenue-share basis with a sports betting or online gaming operator now active in the state will find themselves subject to regulation.



"It is only logical that when your customers, the operators, come under increasing regulatory pressure with regard to their marketing activities, you will be feeling the pressure and have to adjust accordingly as well."

NIKOLAOS KARABELAS
OAKLINS ONLINE GAMBLING SPECIALIST

Payments as a competitive advantage

With regulation starting to have an increasingly large impact on the most important means of competing for online gambling operators, i.e. marketing, players must increasingly strive to scour for new ways to remain at the forefront of the industry. Among inorganic moves, we have seen (and discussed in previous newsletters) players utilize M&A to obtain innovative platforms for acquiring new customers—for instance, LeoVegas' acquisition of online casino streaming network CasinoGrounds. On the organic side of things, innovation is as important—with the online gambling market gradually maturing, distinguishing oneself from the competition through bonus systems and game portfolios is simply not enough anymore. Payments have emerged as one area in which operators can set themselves apart from the competition as they fulfill a key role in player safety (verification) and access to funds.

Regulation is shaking things up in the payments space as well. In September 2019, the second installment of the European Payment Services Directive (PSD2) comes into force. The directive introduces strong customer authentication (SCA), which for many operators will take the form of 3DS2. The introduction is expected to alleviate bottlenecks pertaining to player conversion, especially on mobile devices, by enabling a more streamlined user experience through the use of modern technologies to exchange data and verify the transaction. SCA may also contribute to the increasing player adoption of e-wallets, such as Apple and Google Pay, as these already satisfy the regulatory requirements.

As touched upon above, a key function of payments within online gambling is access to funds, where players frequently deposit and withdraw cash as they wager. When players decide to withdraw funds—winnings or not—they want quick access, another catalyst for increased adoption of e-wallets. Testament to this, 59% of participants in WorldPay's Mobile Payment Journey said that they would be willing to use a different payment method if winnings could be received more quickly. That said, card issuers are catching up. Visa released FastAccess Funding in 2018, slicing payout times to near real time (under 30 minutes) from standard original credit transaction (OCT) timelines of two to five days. Mastercard's equivalent, Mastercard Send™, looks set for European launch during 2019. In light of rising customer acquisition costs (CAC) and demographic aspects, such as the increasing share of players raised in the digital era (Gen Z and Millennials), it will be interesting to see how operators adapt to the availability of these services, as well as their impact on withdrawal behavior and customer loyalty.

A final point on payments is one of user experience. On the one hand, consumers transacting online are demanding non-disruptive, seamless payment experiences that are as close to instant as possible. On the other hand, they are also demanding safety in the form of authorization, especially in the online gambling space where operators may have non-transparent and complex legal structures making it hard to identify the people behind the platforms. To bridge the gap for players and speed up the process of placing a bet, operators can offer payment methods that are familiar to users in other aspects of life, that require little or no setup time. Geographic location often plays a significant role in determining the suitability of a payment solution, hence operators and their platform providers must be flexible so as to offer as many relevant alternatives as possible. Operators can also offer in-bet deposits in their mobile apps as a means to speed up the betting process and distinguish themselves from the competition. In another WorldPay survey, 57% of respondents wanted to make a deposit within the bet slip, rather than abandoning their odds to fund their wallet and then going back to place their bet.

One operator that we spoke to, who prefers to remain anonymous, saw a 30–40% decline in gaming revenues the day following the removal of a popular payment method.

The importance of offering the right payment methods should not be underestimated, especially in today's highly competitive online gambling marketplace.

Recent M&A activity

A selection of recent M&A transactions (Q4 2018–YTD 2019):

Operators (B2C)

Buyer	Buyer country	Target company	Target country	Transaction rationale
888		JPJ Group (bingo brands)		Consolidating its position as one of the leading bingo operators in the UK by acquiring brands that were formerly B2B customers of 888
888		BetBright		Adding a well-established and complementary technology platform for sports betting
River iGaming		Gaming Realms (B2C operations)		Acquisition of Bear Group, Gaming Realms' B2C subsidiary, as well as the residual 30% stake in Gaming Realms' UK casino following the previous majority stake acquisition
Merkur Sportwetten		Totolotek		Geographic expansion into the Polish sports-betting market
Paddy Power Betfair		Adjarabet		Entry into the fast-growing and regulated Georgian market by acquiring a dominant online sports-betting brand
Zeal Network		Lotto24		De-risking of business model by reacquiring former lottery brokerage subsidiary
Vereeni Investments		MoneyBall		Positioning for further growth through access to Vereeni's global reach, expertise within the gaming sector and financing capabilities

Source: Mergermarket and Oaklins research

The M&A activities of YTD 2019 largely follow similar trends to those observed and discussed in our newsletter published in December 2018. Players continue seeking growth opportunities in regulated markets by acquiring strong brands and entering new verticals.

A transaction that stands out is Zeal's re-acquisition of Lotto24 after spinning off the subsidiary in 2012—when Lotto24 was facing obstacles in getting authority permits to act as broker, considering its simultaneous secondary lottery operations. Following German authorities announcing plans to tighten oversight of the secondary lottery sector, Zeal decided to switch its business model by stepping out of the secondary business in favor of legal distribution of state lottery tickets. As part of the move, Zeal applied for permission to broker lottery tickets via its Tipp24 domains, and in November made a move to re-acquire Lotto24, which since the spin-off has grown into Germany's largest distributor of state lottery tickets. The permission was finally granted in February, with the acquisition being endorsed by the vast majority of Zeal's shareholders following irrevocable commitments to accept the offer by shareholders representing approximately 65% of Lotto24 shares. The synergistic acquisition will see Zeal becoming the dominant lottery distributor in Germany.

Another observation is that 888 has been acquisitive recently, following a three-year hiatus since the acquisition of bwin.party. Aiming to own proprietary, end-to-end solutions across the four major online gambling verticals, the group acquired BetBright and its associated sportsbook technology. It also acquired certain bingo brands (already operated on 888's B2B platform) from JPJ in a move to further strengthen its position in the regulated UK market.

As a final note on B2C-related deals, it is interesting to see financial players invest in comparatively new verticals such as fantasy sports. Considering the rise of DraftKings and FanDuel in the US, despite their associated legal battles, it will be interesting to see how Vereeni can contribute to the growth of MoneyBall and the further development of the sub-sector as a whole.

B2B developers

Buyer	Buyer country	Target company	Target country	Transaction rationale
Blueprint Gaming		Project		Expand product portfolio and strengthen presence in the UK market
Sportech PLC		LOT.TO		Enhance existing lottery product offering and support digital development capabilities

Source: Mergermarket and Oaklins research

Affiliates

Buyer	Buyer country	Target company	Target country	Transaction rationale
Natural Intelligence		Sidelines		Attain a strong position in the highly attractive US sports-betting market following legalization in many states
Better Collective		Ribacka Group		Strengthen presence in the newly regulated, rapidly growing Swedish market

Source: Mergermarket and Oaklins research

M&A activity among affiliates has seen a significant slowdown during the first few months of 2019 vis-à-vis previous years. Unlike players in other verticals of the online gambling industry, affiliates have difficulties expanding organically due to the winner-takes-all market characteristics paired with the difficulty in competing via traffic generation. As a result, M&A in the affiliate space is largely driven by geographic expansion, where larger players look to acquire leading positions in new—especially regulated—markets. Thus, a potential reason for the slowdown during 2019 could simply be a scarcity of established and sizable assets in regulated markets following historical high-pace consolidation.

Looking closer at the two recent deals, Natural Intelligence entered the newly unlocked US sports-betting market by acquiring Sidelines.

From Natural Intelligence's perspective, the transaction will secure a foothold in a market that has potential to become the largest betting market in the world.

The acquisition of Ribacka Group by Better Collective is in line with the geographical expansion trend in regulated markets, where Ribacka Group owns a strong network of leading sports-betting and casino marketing platforms in the recently regulated Swedish market.

All in all, when looking at recent transactions across all verticals, there has been high M&A activity within sports betting compared to other verticals. While we cannot point to any specific reasons, it is an observation to note nonetheless. Consolidation is still ongoing but slowing down versus previous periods.

Looking ahead, we expect the consolidation to continue as we move ahead, mainly driven by changes in the regulatory environments across the globe.

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If mergers, acquisitions, or divestitures of businesses or business units are part of your strategy, we would welcome the opportunity to exchange ideas with you.

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