

GREEN PAPER ON ON-LINE GAMBLING IN THE INTERNAL MARKET SEC(2011) 321

RESPONSE OF THE CHANNEL ISLANDS

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and Jersey Gambling Commission (JGC)**

INTRODUCTION

The Channel Islands¹ welcome this consultation on online gambling in the internal market, and value the opportunity to present evidence on their experience of regulating the provision of services to consumers and businesses in EU markets. Alderney has a long history, since before the year 2000, of regulating both the terrestrial and remote gambling industries, while Jersey recently introduced a regulatory system modelled on that of the United Kingdom.

In constitutional and political terms, the Islands are independent democracies that owe allegiance to the British Crown. Their political and legal relationship with the European Union is governed by Protocol 3 to the UK's Accession Treaty to the EU, which extended to the Islands the Customs Union for trade in goods. However in economic terms the Islands are deeply integrated with the United Kingdom and other European countries, and enjoy deep and mutually beneficial collaboration across a wide range of policy areas.

The Channel Islands have voluntarily implemented legislation which accords with EU standards in many areas. For example the Islands' data protection regimes accord with, and have been deemed adequate to, Directive 95/46EC. In addition both Channel Islands regulators have imposed regimes equivalent to the EU's Third Anti Money Laundering Directive. The Channel Islands have been through recent IMF inspections that rated extremely highly the efficacy of their AML/CFT regimes, while they also meet OECD standards for international co-operation on tax matters.

EXECUTIVE SUMMARY

The Channel Islands provide a regulatory environment which offers robust, enlightened and active regulation while also being responsive to the needs of a changing European industry. In this way, the Channel Islands aim to attract operators who seek a comprehensive and tightly controlled regime, to protect the interests of players and the public, and to maintain the jurisdictions' high reputation with EU member states and institutions.

In order to achieve these aims, the Jersey Gambling Commission (JGC) and Alderney Gambling Control Commission (AGCC) have introduced licensing regimes tailored to the needs of the remote gambling industry and matching or exceeding European standards. Legislation is in place that protects the interests of both the consumer and public at large. Certification and software testing requirements ensure the fairness of the games offered to the public, while systems are in place that facilitate proper control of the games offered. AGCC

¹ The British Crown Dependencies of the Bailiwick of Guernsey (which includes the Island of Alderney) and the Bailiwick of Jersey

and JGC also have well-established enforcement processes and police structures to prevent crime, money laundering and the financing of terrorism.

The Channel Islands are concerned that Europe should not replace protected national markets with a protected European market: To protect consumers properly, the single market must also be one that is open to responsible regimes in the rest of the world. Blocking respected operators from doing business across borders is often ineffective, but cooperation with regulators in non-European jurisdictions, where the large majority of dot com sites are based, provides Member States with a method of reaching operators located in third countries, facilitating a higher degree of law enforcement.

This response therefore consists of four sections outlining evidence related to four main issues:

1. The risks associated with fragmented and/or closed European markets, which can arise from countries including 'geographical' criteria in their licensing regimes to favour national operators (related to questions 3, 4, 5 and 10 of the Green Paper)
2. The opportunities of reducing barriers to entry for business-to-consumer and business-to-business service provision (related to questions 3 and 6 of the Green paper)
3. The importance of objective and transparent common European standards for regulatory cooperation (related to questions 28 and 37 of the Green paper)
4. The role of Channel Islands in law enforcement co-operation with international partners and EU member states (related to questions 14 and 48 of the Green paper)

SECTION 1: The risks associated with fragmented and/or closed European markets (related to questions 3, 4, 5 and 10 of the Green Paper)

The Commission Green Paper notes the projected high growth of the EU market in on-line gambling, which is reflected worldwide. For example H2 Consultancy expects the global industry to grow to be worth some \$30billion (USD) by 2012, with further growth possible thereafter. Having closed and/or fragmented markets harms consumers, increases risks of illegal activity, and risks excluding European operators from sharing in the global growth and the wider economic benefits of the industry.

Fragmented markets

Fragmented markets are costly and risky markets. Duplication of licensing, testing and inspection, coupled with requirements to establish and locate equipment in specific locations, raises costs for business. This disadvantages the consumer and may even make it unviable for operators to offer regulated gambling activity. It also provides a disincentive to operators who would, in an open market, establish operations. This can result in players either having to utilise state monopolies or seeking unregulated service providers. The availability of odds checkers and comparison sites enables customers to seek out operators offering the best returns, wherever they may be based. The use of rudimentary technical knowledge is often sufficient to thwart efforts by jurisdictions to insulate their markets by the use of IP address blocking.

Fragmented markets also mean that citizens of Member States are treated differently, as are the businesses established to service them. This can create confusion amongst players given the nature of the product being internet based. Meanwhile a lack of legislative certainty in a jurisdiction may also lead operators to elect not to offer their products into that market, further encouraging customers to seek out operators located in unregulated or less well regulated jurisdictions.

Closed markets

Closed markets, particularly in smaller jurisdictions, may result in responsible operators concluding that the returns that may be made do not warrant the costs of entry into that market. In games where liquidity is important such as poker and bingo this may limit the attraction of “authorised” operators, whose prize pools may consequently not compare favourably with those located elsewhere and which can be accessed relatively easily. As well as degrading the experiences of their consumers, closed markets also increase the risks of consumers seeking out unregulated operators or operators based in less well regulated jurisdictions.

There is therefore a strong argument that the more recognised or authorised operators there are in a market the less likely consumers will be to seek out operators elsewhere. The authorised operators may not necessarily be based in that jurisdiction, but appropriate agreements and common standards can enable Governments to be certain that their citizens are adequately protected.

SECTION 2: The opportunities of reducing barriers to entry for business-to-consumer and business-to-business service provision (related to questions 3 and 6 of the Green paper)

The main opportunities of reducing barriers to entry for service provision come in the form of benefits to customers, as the EU has consistently demonstrated with its strong leadership and single market reforms in other sectors. In the case of the e-gaming sector, this would take the form of better odds and increased liquidity, leading to better paying and more appealing games. The experience of the Alderney regime in licencing different types of activity demonstrates these benefits for EU consumers, both directly as customers of Alderney-based companies and indirectly as customers of firms based in other Member States that use services based in Alderney.

The Alderney regime licences two types of activity. Category 1 licences allow an operator to offer gambling services to members of the public with the holders of Category 2 licences effecting the gambling transaction. It is possible for one Category 2 licensee to provide gambling services to a number of Category 1 licensees. By differentiating between Business to Business (B2B) and Business to Customer (B2C) activity it is possible for a B2B provider to offer gambling services into a number of jurisdictions, for example, where domestic licensing regimes which regulate the relationship with the customer have been implemented.

This “separation” model has been well received by the remote gambling industry as it allows for specialisation to develop in that companies who only wish to develop games and gambling platforms can do so focussing on their core activity whilst not having to deal with the public. Similarly it enables customer facing operators to offer gambling by “buying in” the gambling platform saving development costs, offering more and better games and increased liquidity in games such as bingo and poker.

Splitting the licence into component functions enables B2B operators in Alderney to offer their platforms to B2C operators based elsewhere in the world. This functions well with the models being implemented in Europe where those offering gambling to the public are required to hold licences in individual jurisdictions. For example B2C operators in four Member States could utilise the platform of one B2B operator, whether in Europe or elsewhere in the world, pooling liquidity (if permitted) or otherwise making use of infrastructure that would be costly if required to be located in each Member State. By reducing the costs of operating, a better and more cost efficient offering can be made to the consumer who can then make an informed choice to gamble with a regulated entity rather than seeking out operators in unregulated jurisdictions who may be offering better odds or greater returns to players (RTP). The availability of odds checking websites and comparison sites in an internet based industry gives players knowledge of where to go for the best returns and if there is a mature, ordered and regulated market offering products that are the same or better value as those in unregulated or less well regulated jurisdictions consumers are likely to contract with those they feel more comfortable with.

Operators have demonstrated a willingness to submit themselves to strong regulatory regimes such as those in place in the Channel Islands, where the regulatory requirements may be higher than other jurisdictions. There is clear evidence that this is done on the basis that the operators have brands they wish to protect or are listed companies whose compliance obligations steer the choice of domicile. For example Virgin group and Sky are multinational

blue chip conglomerates that have Alderney-based licensees, while other licensees, such as Gala, Sportingbet, and Blue Square, are mainstream UK companies who take their reputations very seriously. Indeed the latter two are listed, or subsidiaries of listed companies, on the London Stock Exchange and consequently are required to adopt high levels of corporate governance.

SECTION 3: Objective and transparent common European standards for regulatory cooperation (related to questions 28 and 37 of the Green paper)

Common policy objectives

Common standards and regulatory cooperation are the foundations of an efficient market, while regulatory cooperation benefits legitimate industry and affords greater consumer protection and works to reduce the risks of criminal involvement. AGCC and JGC's discussions with other regulators indicate strongly that all EU Member States share similar policy objectives with regard to regulating the E-Gaming sector, and that greater mutual confidence is a condition of realising the benefits outlined in Section 2.

For example, the Alderney Gambling Control Commission underpins its Mission Statement ("The mission of the Commission is to ensure and maintain the integrity of the electronic gambling industry in Alderney" with three core objectives:

- All electronic gambling on Alderney is conducted honestly and fairly;
- The funding, management and operation of electronic gambling on Alderney remains free from criminal influence; and
- Electronic gambling is regulated and monitored so as to protect the interests of licensees' customers as well as the young and vulnerable.

Meanwhile the Jersey Gambling Commission follows three guiding principles:

- Regulate in accordance with generally accepted international standards to prevent fraud and money laundering, and prevent gambling being permitted to be a source of crime;
- Ensure products and services licensed by the Commission are verifiably fair to consumers of those services; and
- Ensure licensees act responsibly and implement safeguards necessary to protect children and vulnerable people.

EU Standards and 3rd Countries

The Channel Islands have demonstrated that it is possible for third countries to establish and regulate a well ordered market in online gambling, and that this has served to benefit customers and the industry. The Channel Islands impose regulatory regimes that meet with or exceed the as technical requirements, game testing and certification suggested by the International Association of Gaming Regulators (IAGR), and that are equivalent to or higher than those of many EU Member States, for example the AGCC requires that operators report all changes to their gambling equipment however minor. . The Channel Islands would like to see aspects of their regimes implemented more widely, such as the testing of games and auditing of changes, and believe that only with regulatory cooperation and recognition of testing carried out by other regimes to agreed standards could such safeguards properly work given the costs involved.

Common standards would mean that operators can work to a set of standards which affect all operators which thereby affords equal treatment. In addition the imposition of common standards means that there would be increased customer confidence which could in itself serve to increase the size of the market. Where customers are uncertain about something it is

more likely that they would avoid participation. It also assists operators to have common standards in areas such as customer identification and verification. By having common identification and verification procedures levels of criminal activity can be reduced and greater player protection procedures can be implemented.

Cooperation with other jurisdictions

The Channel Islands cooperate with other jurisdictions in setting their regulatory frameworks. For example the AGCC is “white listed” by the United Kingdom and its licensees can offer gambling services into the UK as if they were regulated there. The Channel Islands note that the UK is seeking to change its licensing regime but welcome the announcement that operators in white listed jurisdictions will be viewed favourably with regards to licensing applications.

In terms of multilateral co-operation, both regulators in the Channel Islands are long standing members and participants at the Gambling Regulators European Forum (GREF). Both regulators are members of the Technical Working Group and Internet Working Group of GREF with the JGC CEO being the current co-chair of the Technical Working Group. Both regulators are represented at IAGR with the AGCC’s Executive Director being a past Chairman of the Association and the AGCC’s Chairman having chaired IAGR’s eGambling Working Group from its inception to 2007. IAGR and GREF both strive to harmonise standards and engender regulatory cooperation.

In terms of bilateral co-operation, the AGCC has a number of agreements in place to cooperate with Member States and third countries. These include agreements with Khanawake, Antigua & Barbuda and the Nevada Gaming Control Board. The AGCC has also recently agreed the terms of a bi-lateral cooperation agreement with Denmark.

Commitment to consumer protection

The Channel Islands regulators place consumer protection, including protecting the weak and the vulnerable, at the heart of their regimes with detailed regulations. Strong player identification controls work to prevent multiple accounts being created (protecting against problem gambling and the risks of accounts being used for criminal purposes). A monitoring obligation requires operators to identify those who may be at risk of becoming problem gamblers and to deal with them appropriately. In addition Alderney operators are required to make contributions towards the research into, education about and treatment of problem gambling. The JGC has a hypothecated Social Responsibility Fund into which licensees make voluntary donations. The JGC has powers to enforce a levy of up to 1% of gross turnover should licensees be unwilling to donate voluntarily.

Strong customer identification procedures and due diligence procedures work towards mitigating the risks that arise in non-face to face transactions, such as credit card fraud, identity theft/duplication and money laundering/terrorist financing. Studies such as the MHA Consulting report² of June, 2009 and the Levi report³ of September, 2009, have demonstrated

² http://www.rga.eu.com/data/files/final_mha_report_june_2009.pdf

³ http://www.egba.eu/pdf/Levi_Final_Money_Laundering_Risks_egaming%20280909.pdf

that the risks of such activity in the on-line gambling sector are often overstated; the inability to use cash, a requirement to keep audit trails (allied to monitoring designed to identify suspicious activity) and the risks of total loss render online gambling less attractive to money launderers than other activities. This protects both those who gamble and the public at large.

The AGCC also has in place strict obligations regarding advertising. These obligations are contained in regulations and have legal effect. They meet with internationally recognised good practice which benefits both those who gamble and the wider community by ensuring that the advertising that takes place is appropriate and suitable to the method of delivery.

Testing and on-site inspection

Customers of firms based in the Channel Islands are protected by requirements for testing all gambling equipment to ensure a fair gambling experience. Prior to commencing operations, operators must have their internal processes approved, which in Alderney takes the form of an “Internal Control System” (ICS). This identifies the procedures to be adopted by the operator in all key areas such as the customer relationship (including identification and verification), AML/CFT controls, identification of problem gamblers, the integrity of the gambling which includes game security, physical security (including that of hosting facilities) and game fairness, as well as reporting to the regulator in respect of financial processes, issues that arise and changes made to systems used. Any changes to this operations manual must be approved by the AGCC, and each operator is inspected annually to ensure that they are operating in accordance with their approved processes. AGCC is concerned that without open EU standards, the rapid development of remote gambling jurisdictions across Europe may not include the same prioritisation of player protection issues. The emergence of regimes seeking taxation without proper regulation is likely to have a major negative impact on the industry as a whole, increasing the otherwise manageable risks of problem gambling by facilitating commercial operations that are not correctly supervised in the relevant areas.

The on-site inspection regime is a key feature of Channel Islands regulation. The inspection takes place at the locations where the operator performs various functions wherever these may be located in the world. The inspection involves inspectors from a number of disciplines spending several days confirming that the operator is operating in accordance with its approved ICS. Any deficiencies found are noted and identified to the operator who is then required to remedy these issues. On occasion the AGCC has identified issues that have resulted in it issuing formal sanctions to the operator concerned.

The AGCC has developed an on-line portal for licensees to use to communicate the changes they wish to make to their gambling equipment. This requires the licensee to rate the “risk” of the change and allows the AGCC to prioritise those that may have the greatest impact on game fairness and customer protection.

The preparation of an ICS is time consuming for the operator to prepare and also for the regulator to review and approve but experience has shown that it pays dividends in providing a template against which to base inspections as well as providing a basis upon which failings can be identified and acted upon. Operators are in favour of having an ICS and recognise that, once prepared, it gives them an operating manual that covers the issues they must deal with

on a daily basis. In addition a robust player complaints procedure ensures that customers have the ability to have their grievances heard and considered by an impartial panel.

Both the AGCC and JGC require that all games and products offered by operators in the Channel Islands are independently tested prior to being released. Testing is carried out by independent testing houses instructed by the regulator giving the regulator privity of contract over the results. Common standards would mean that operators would only be required to have their games tested on one occasion. This would also serve to be a benefit under (2) above. Random Number Generators are checked to ensure that they are random and operate within defined parameters. Upon the satisfactory conclusion of the testing process the games are allowed to be offered to the public as approved gambling equipment.

The AGCC requires that any changes, however minor, made to approved gambling equipment are notified to the AGCC. The AGCC logs these changes and may require that further testing be undertaken. During the annual on-site inspection any changes made to gambling equipment are reviewed. Changes made without notification to the AGCC could amount to an offence under Alderney legislation and amount to a regulatory event.

In addition operators are required to implement systems which identify suspicious activity. Such activity can, in peer to peer games, compromise the experience of the public. For example “chip dumping” in poker can be identified by those offering the game and, when identified, the transactions can be voided and if money laundering is suspected a report made to the appropriate Financial Intelligence Unit.

SECTION 4: The role of Channel Islands in law enforcement co-operation with international partners and EU member states (related to questions 14 and 48 of the Green paper)

The AGCC's processes operate to prevent crime on a multi-level basis. The application process for a licence, coupled with the vetting process imposed on beneficial owners and key employees, work to deny licences to those with criminal backgrounds. AGCC licensees are required to operate to strict standards which cover the following areas:-

- Customer registration and verification (included enhanced procedures where appropriate)
- Regular review of customer due diligence information.
- Monitoring and analysing customer activity
- Record keeping requirements
- Obligations to report suspicions
- Requirements to screen and train employees

Significant numbers of applications fail to be pursued upon realising the depth of the AGCC's checking. Indeed these processes have been responsible for operators actually electing to leave Alderney to be regulated in jurisdictions where the regulator imposes fewer obligations. It should be noted that the standards imposed by the AGCC come with direct and indirect costs to operators.

The Channel Islands regulators also work with their local Financial Intelligence Units (who are members of the Egmont Group) and other law enforcement bodies which work to ensure that online gambling conforms to the high standards required of the wider financial services industry.

The Channel Islands play an important role in European law enforcement. Where requests are made for cooperation the Channel Islands will cooperate. The AGCC has a track record of cooperating with investigations being conducted in other jurisdictions, notably the United Kingdom and France.

There are challenges to regulatory co-operation arising from gambling being a matter of subsidiarity in Europe, which makes cooperation with the rest of the world dependent on will of each member state. This can result in a situation where some members are keen to cooperate with third countries and others not, which further weakens effective law enforcement and player protection.

The Channel Islands are therefore concerned that Europe should not replace protected national markets with a protected European market: To protect consumers properly, the single market must also be one that is open to responsible regimes in the rest of the world. Blocking operators who are not licensed in a member state from doing business is often ineffective, whereas cooperating with regulators in non-European jurisdictions, where the large majority of dot com sites are based, will facilitate a higher degree of law enforcement in that it provides Member States with a method of reaching operators located in third countries.

The AGCC is not afraid of taking regulatory action against its licensees and their key employees where they consider it to be in public interest. In 2010 the AGCC suspended the licence of an operator prior to a regulatory hearing after discovering that the procedures of

that licensee failed to identify a problem gambler allied to other customer due diligence failings. In 2011 the AGCC suspended 4 licences pending a hearing by its Commissioners which essentially relate to protection of player funds. In addition in a previous regulatory matter the AGCC sought information from another regulator about levels of activity in their jurisdiction where it concerned an operator with dual licences. Obtaining this information enabled the AGCC to construct its case against the operator in a regulatory hearing in which ultimately the operator accepted the allegations levelled against it and received a sanction.

Internet gambling is a mobile market. Operators are flexible as to where they base their business. Their choice to locate in the Channel Islands reflects the regard in which they hold the regulatory regimes. The Channel Islands have developed gambling regimes that are recognised as being amongst some of the best formulated in the global market. This recognition is manifested in the number of jurisdictions who are seeking to regulate online gambling consulting with and taking the advice of Channel Islands regulators. The AGCC has been consulted by a number of jurisdictions and has given evidence on many occasions regarding the benefits of regulation and regulatory cooperation.