Raising the stakes

Tim Porter and **Nick Parfitt** consider the compliance challenges facing the gaming industry

In the first in a two-part series, we consider the current state of regulation in the gaming and gambling sector in the UK, some of the specific features of compliance, and the near-term challenges that operators face. In the second instalment we will share insights from the global industry and suggest a model for compliance.

Scope and scale

Let's start with some background, beginning with terminology. 'Gaming' is increasingly associated with video and electronic games rather than the practice of gambling. We use the terms 'gaming' and 'gambling' synonymously in this article. The UK's Gambling Act of 2005 defines gambling as "betting, gaming or participating in a lottery". The UK regulator is the UK Gambling Commission (UKGC), which exists to "licence and regulate people and businesses that provide gambling". Gambling activities are categorised by the regulator into sectors: arcades, betting, bingo, casinos, lotteries and gaming machines. UKGC permits gambling and grants licences under the Gambling (Licensing and Advertising) Act 2014 in line with the following "licensing objectives":

- Preventing gambling from being a source of crime or disorder, being associated with crime or disorder, or being used to support crime
- Ensuring that gambling is conducted in a fair and open way
- Protecting children and other vulnerable persons from being harmed or exploited by gambling.[1]

The gambling industry in the UK is now worth around £13.8bn[2], employing around 107,000 people[3] across some 2,800 different operators. UKGC has a staff of around 300 and a budget of £20m.

From an anti-money laundering / counter-terrorist financing (AML/CTF) perspective, casinos have been regulated since 2007, but it wasn't until the introduction of the 4th EU Anti-Money Laundering Directive (4AMLD) in 2017 that the rest of the gaming industry came under regulation. So now, for online gaming operations through to the local bookmaker, preventing money laundering and countering terrorist financing are critical, and appropriate processes and controls must be in place. UKGC has provided comprehensive guidance on AML/CTF in two documents: one for casinos and one for the rest of the sector.[4] In March this year, it published its "Money laundering and terrorist financing risk assessment 2017"[5] and it expects all operators to be aware of these risks in their operations.

Eyes down

And the regulator isn't taking any nonsense. It has issued fines totalling £8.3m in 2018 so far, as well as publishing a detailed report on the state of compliance within online, UK-registered casino operators. It's interesting to note that whilst AML fines account for the majority of the value of penalties, the regulator's focus on strengthening social responsibility in gambling has led to a much larger number of individual fines relating to these types of breaches.

As recently as 20 June 2018, UKGC announced a penalty against 32Red for failure to protect a consumer from gambling-related harm, and weaknesses in AML processes.

Readers are likely to be have heard that fixed-odds betting terminals (FOBTs), described as a "social blight"[6] by Matt Hancock, the UK's Digital, Culture, Media and Sport Secretary, have reduced stakes from £100 to £2. In a single year, there were 233,000 cases in which individual gamblers lost more than £1,000 each[7] on these machines. The move to reduce stakes will, of course, cut revenues to bookmakers, but it seems to us to be both welcome and long overdue.

Cultural and business-model nuances of gaming

There are considerable differences in the business risks and relative maturity of compliance within the gambling industry. Traditional onshore casino operators have better-established and more rigorous controls in place compared with online operators, some of whom are based offshore. This may not be surprising, given that 4AMLD is relatively new.

There are also, in our view, clear cultural and behavioural differences between different operators. Concerns over brand and reputation mean that well-established onshore operations have lower risk tolerances, and their dedicated compliance teams are more expert in dealing with the risks to which they are subject. However, the fact that gamblers principally use cash in onshore outlets creates a high degree of opacity in which to launder illicit funds. And while AML/CTF programmes are better established in these outlets, they are often inconsistent and inadequate, as recent UKGC penalties show.

Note that in the gambling sector money laundering tends to be the exchange of funds acquired criminally for money or assets that appear to be legitimate, with gambling operators used for channelling the funds through a form of legitimate business transaction or structure. However, the proceeds of crime may also be used to fund gambling as a leisure activity for criminals themselves. Both typologies may be deeper-rooted in casinos and bookmakers.

Compared with traditional onshore businesses, online gaming operators tend to be highly entrepreneurial and tech-savvy. The have seen rapid growth over the past five years, and may not have given regulatory requirements and compliance the priority they deserve. But it is interesting to note too that the perceived AML/CTF risk in online ►

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gaming is much lower than in onshore operations, because everything is digital and in many cases traceable back to a bank account. This is particularly relevant to operators' obligations to ensure responsible gambling; to monitor behavioural patterns beyond actual spend; to identify gamblers who have opted for 'self-exclusion'; and to be able to quickly report concerns to the regulator. It does, however, assume that appropriate systems and controls are in place and working, a relatively big assumption that we will examine shortly.

A clean sweep

Following a thematic review of the sector, UKGC wrote in January of this year to all 195 UK online casino operators warning them to review their procedures and to improve measures that protect customers and prevent money laundering. MLROs were even identified as having no formal qualifications and in some cases were "unable to provide suitable explanations as to what constitutes money laundering".[8] These findings – combined with a lack of customer account usage monitoring, poor analysis of players' socioeconomic indicators and no rigour in filing Suspicious Activity Reports – suggest that even basic Know Your Customer principles appear to be absent.

This poor understanding of customer behaviour is also reflected in the UKGC's findings, which showed failure to detect "potential signs of problem gambling based on consumers' gambling pattern and spend" that "in many cases, however … did not trigger a customer interaction". This suggests that account behaviour is either not being monitored at all or is simply being ignored. It also calls into question whether a player's actual funds and income supports their level of play, and whether the associated AML implications are understood and controlled effectively.

Failure to address these concerns could result in licences to operate in the UK being revoked. The UKGC further stated that it is investigating 17 online operators and considering whether five of these require a licence review.[9]

Where to from here for online operators?

These organisations have a great deal of work to do if they are to stay in business. The level of effort and cost required should not be underestimated. However, the regulatory and compliance focus should be seen less as a challenge and more as an opportunity to move forward. Successful companies have found a balance between short-term initiatives and longer-term structural changes.

In the short term, operators should carry out the following initiatives:

- **Apply customer due diligence (CDD) measures** to any transaction that amounts to €2,000 or more, whether in a single operation or in several operations that appear to be linked. IT systems need to be capable of monitoring scenarios to support compliance with this regulation.
- **Conduct enhanced due diligence (EDD)** where a customer presents a higher risk of money laundering, and put a risk assessment model in place to determine which customers pose a higher risk.
- **Develop the capability to monitor customer accounts.** UKGC found little evidence of ongoing monitoring of customer accounts, which means that operators are in breach of Regulation 28(11) of The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017. It also means that money laundering and/or responsible gambling issues go unreported.

Being under regulatory scrutiny is not comfortable. But with the correct focus, business engagement and culture – the 'tone at the top', 'mood in the middle' and 'buzz at the bottom' – change is possible. As banking industry players are doing, gaming operators should learn from successful peers and use what they learn to differentiate themselves and create competitive advantage.

In our follow-up article we will look at the gaming industry globally, exploring the jurisdictional nuances of the online operators, sharing views from the operators and looking at a longer term model for compliance in the industry.

Tim Porter is Director at Tim Porter Associates.

Nick Parfitt is Head of Market Planning at C6 Intelligence Group

1. http://www.gamblingcommission.gov.uk/about/Who-we-are-and-what-we-do/Who-we-are-and-what-we-do.aspx
2. http://live-gamblecom.cloud.contensis.com/PDF/Annual-report-and-accounts-2016-2017.pdf
3. Ibid
4. http://www.gamblingcommission.gov.uk/for-gambling-businesses/Compliance/General-compliance/AML/How-to-comply/How-to-comply-with-your-anti-money-laundering-responsibilities.aspx
5. http://www.gamblingcommission.gov.uk/PDF/AML/Money-laundering-and-terrorist-financing-risk-assessment-March-2018.pdf
6. https://www.thetimes.co.uk/article/2-limit-to-curb-crack-cocaine-of-gambling-ftc6v37hr
7. https://www.theguardian.com/commentisfree/2018/may/17/the-guardian-view-on-fixed-odds-betting-terminals-the-bookies-lose-at-last
8. http://www.gamblingcommission.gov.uk/news-action-and-statistics/news/2018/Letter-to-online-casino-operators.aspx
9. Ibid.