

LEGAL UPDATES

ONLINE GAMBLING

The price of success

The costs of operating in the maturing online gambling sector are on the rise and there are certain standards of social responsibility to which online operators need to adhere as the sector continues to consolidate. **Stuart McMaster** explains



While the cost of entry to the online gambling sector has historically been low, the cost of success seems set to rise as a result of the increasing focus on higher standards of social responsibility and best business practice. There are understandably sound business reasons for such an approach. For example:

- Businesses in this sector are highly dependent on brand reputation, and investment in higher standards of social responsibility and business practice may be a means of elevating brand reputation, inducing customer loyalty and thereby gaining a competitive advantage.
- Regulators of online operations have reinforced the need for businesses to adopt and implement stringent operational and technical policies and procedures to safeguard those exposed to the online gaming environment. The industry, at large, will have greater success in influencing the scope of regulation if it can demonstrate that it is able to address successfully the underlying policy concerns.

Adherence to higher standards of social responsibility and business practice may increase operating costs. For example, age verification procedures are costly to implement, and may adversely affect customer sign-up rates. Some operators may regard the adoption of such standards as contrary to their self-interests, particularly if they are located in a lightly-regulated jurisdiction.

However, operators looking to be acquired may find that the failure to adopt higher standards adversely affects the price of their business. Those advising in relation to M&A activity in the online gambling sector are likely to find that due diligence and warranties focus increasingly on the following issues:

- Licensing — a purchaser subject to a high level of regulation will need to consider the cost of elevating the business practices of a prospective target located in a less extensively regulated jurisdiction.
- Customer care — a purchaser will want to analyse the various drivers which affect customer retention rates, such as payment policies and the average times for return of funds, the complaints handling training given to customer-facing staff, and operational data regarding the outcome of complaints.
- Data protection — reviewing compliance with EU data protection laws will be important, particularly where:
 - (i) the target is based in the EU and processes personal information in the EU;
 - (ii) the target is established outside the EU but uses equipment within the EU to process personal information; or

(iii) the purchaser is based in the EU and intends to use the target's customer lists for the purposes of cross-selling its own products. Have customers been given the option to prevent their personal information being used for the purposes of direct marketing? The purchaser may need to take account of the cost of curing any defects with the data, or forego anticipated synergies if the personal data cannot lawfully be processed in the EU.

- Protection of customer funds — the purchaser will need to ascertain whether customer funds are ring-fenced, and how well customer accounts are guarded against fraud. How often are security systems tested and updated by external security consultants?
- Money-laundering procedures — what anti-money laundering (AML) procedures are conducted by the target, and do these comply with the laws of the jurisdictions in which the target operates? Where the target sub-contracts its AML procedures to payment processing agents, does the contract provide that the processing agent will supply the target on demand with all information, which the target requires to comply with applicable laws? Operators who disregard AML requirements on the basis that these hinder customer acquisition ultimately risk undermining profitability by increasing the potential for customer fraud and charge-backs.
- Protection of minors — what procedures are used by the target to deny access to minors? How robust are these procedures (do they, for example, involve third-party checks of account registration details against public records), and what operating data is available regarding the number of sign-ups declined as a result?
- Problem gamblers — what training is given to customer-facing staff in relation to problem gamblers? Does the target offer customers self-assessment tools, cooling-off periods or even self-exclusion facilities? Operators need to resist the temptation not to address problem gambling on short-term considerations.

As the market matures further, consolidation in the sector is likely to give rise to a 'trickle-down effect' as far as social responsibility and good business practice are concerned. Purchasers committed to higher standards will take into account the cost of consolidating a business, which does not comply with best practice. If established on the basis of worst rather than best practice, businesses looking for exit opportunities face a more critical analysis by purchasers of their prospective worth.

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