INVESTING IN UK IGAMING

The UK gambling industry offers of a wealth of different opportunities for investors. **Bahar Alaeddini** of **Harris Hagan** explores the headline risks and issues that need to be managed when investing and how to address these.

The unknown unknowns

There are no sure bets. As an investor you will never know everything about the target company, but you need to know enough to make an informed decision regarding your financial investment, including whether the company has the right licence or if there any reason why they would not be granted one. Licences are often overlooked, which is unwise because they cannot be granted overnight, taking a minimum of two to three months. The Gambling Commission (the "Commission") does its due diligence on a company applying for a licence to ensure it is suitable by applying five key factors: identity and ownership, finances, integrity, competence and criminality. We recommend that investors apply these factors when doing their own due diligence.

You can find out a lot from the company itself, but you should never rely on that alone, given the obvious conflict. As an investor, we recommend you appoint a specialist gambling lawyer, independent to the company's, to act on your behalf. The company will desperately want the investment and, unsurprisingly, they will instruct their lawyers to put a positive spin on legal threats and regulatory hurdles. It is always worth asking your lawyer about the commercial aspects of the investment. Often investors have no real experience or depth of understanding of the iGaming industry. True specialist gambling lawyers will bring a useful sense of perspective.

It is worth noting that the Commission will investigate you, personally, if you reach certain thresholds. If as an individual you hold 3% equity or voting power or more you will need to be named and your DOB provided. At 10% equity or voting power you will need to provide a detailed personal declaration, known as an Annex A application. If you are backed by other investors, you will need to consider with your lawyer the extent to which you are investigated; this will be assessed on a case-by-case basis.

We often experience resistance on the part of financial institutions, such as private equity houses, to regulatory investigation and work with them to keep it to a minimum. Every case is different but relevant factors include the level of equity, extent of day-to-day influence, executive directorships and whether they are FCA-regulated.

Bad reputation

If the company is already licensed by the Commission, it could still have a bad reputation with the regulator. Reputation is very important because without a licence the company cannot trade. This risk can be minimised by finding out as much as possible from asking around in the industry, reviewing the Commission's sanctions register and correspondence with the Commission to assess the tone. It is therefore important to have a feel for the company's relationship with the Commission and dealing with a company that considers regulatory compliance as important. Regulators can change their approach dramatically and suddenly, and whilst regulatory compliance is not a sexy subject, it is very important and you need to deal with a company that considers it as such, otherwise it will soon experience difficulties.

It is also worth bearing in mind that a change of lawyers can help here. If the company is instructing specialist gambling lawyers with an established working relationship with the Commission, it provides the Commission with a degree of comfort that the Company understands what the regulator expects of its licensees, particularly in terms of openness and transparency, and that a certain amount of due diligence is being undertaken even before applications are put before the Commission for consideration.

Regulation

Quite simply, the company needs robust processes to comply with legal/regulatory requirements in all jurisdictions in which it operates, particularly given that levels of regulatory oversight are only going in one direction. Regulation in itself is not a risk, but continually changing regulation, particularly in relation to iGaming, could result in regulatory breach, sanction and damage to the company's reputation, if it does not foster the right attitude or approach.

Failures have consequences in the home jurisdiction as well as the target jurisdiction as regulatory or enforcement actions are both reportable elsewhere. Technical systems can and do fail; for example, they could fail to block play from the US, or fail to detect money laundering or problem gambling signs. It is worth bearing in mind that some breaches attract criminal liability; in the form of possible fines, back taxes or even imprisonment. As an investor you need to understand the risks taken by the company which you are funding. The only ways to address these risks entail engaging with the Commission, knowing when to seek advice and engaging the services of reputable service providers.

To give you a flavour of the Commission's current thinking on regulatory issues, former CEO Jenny Williams commented earlier this year that operators had been "focussing far more on commercial risk than on meeting licensing objectives." Social responsibility and anti-money laundering are undoubtedly key areas for Sarah Harrison, the new CEO.

Social responsibility

According to former Director at the Commission, Matthew Hill: "Choices facing the industry…there are really two doors out of this room. One door leads to greater constraint…[t]his is the door that is opened by industry's failure to act. The other leads to a somewhat sunnier place. It involves the industry – and its leaders – understanding and taking public concern seriously and responding to it by devising and testing practical measures to reduce harm."

This is a key area for the Commission. Around 73% of adults in Great Britain gamble at least once a year; the vast majority do so responsibly. All operators have a shared responsibility to help players gamble responsibly by not spending more money or time than they can reasonably afford. The Commission does not want to stop operators from being successful. However, recent public scrutiny has meant that the industry must step up its efforts in social responsibility to prove it can be "trusted". There is no substitute to complying and offering socially responsible products. Additionally, you could encourage the company to engage with Commission consultations or visit GamCare, who operate an open door policy for operators.

Leading operators have finally grasped the correlation between social responsibility and profits. It may have taken threats to television marketing, FOBTs and damaging public statements, but they are beginning to incorporate social responsibility in their business DNA.

Foreign jurisdictions

It is often overlooked, but a Commission licence only authorises activities here in Great Britain. Different laws apply in foreign jurisdictions. This is an area of great interest to the Commission.

The trend is to operate in white jurisdictions, but grey markets offer a good short/medium-term strategy. In the long term, the number of grey markets is contracting, with markets often closing overnight. The risk attached to grey jurisdictions should be considered in the context of the ever-changing EU gambling landscape, emerging national licensing trends and the increasing interest of regulators in other jurisdictions (such as Great Britain) regarding what you are doing elsewhere. Foreign markets clearly offer a wealth of opportunities, but a business heavily reliant on grey jurisdictions will not be as financially stable as others.

It is important for investors considering their exit routes, to remember that every £1 of profit from a white jurisdiction attracts a higher valuation multiple than £1 of profit from a grey market. Again, there is no substitute to the company, and you, doing due diligence and knowing when to seek legal advice. Markets take years to open up, but when they do the company needs to act fast to avoid breaching foreign laws and avoid calling into question their suitability to hold a licence at home.

Change

Great Britain is a highly competitive, rapidly advancing and open market. The market develops rapidly as a reaction to technological advances and customer demand. Now more than ever, customers expect exciting and engaging experiences at the click of a button. The open legal landscape in Great Britain means that licences are available for almost everything, so competition will follow swiftly in the wake of any innovative product or other initiatives.

Final thoughts

Don't be put off by risk; rather, identify the options, weigh the risks against the benefits, and establish your own appetite for risk. Things can and do go wrong, but a good business will learn from both its positive and negative experiences and is wise enough to know when to seek advice. The key is to turn mistakes into learning experiences to prevent reoccurrence. The Commission appreciates things go wrong and breaches will occur, but how a company responds to its breaches will influence and shape its relationship and reputation with the Commission. For example, if it works in an open and transparent manner, this will bode well for its reputation, but if the same types of breaches reoccur, it will not bode well.

That said, investing in this space undeniably offers a wealth of opportunities and potential rewards. Risk is a natural part of business and gambling, perhaps more than anything else, has this at its very core; the key to success is how this risk is managed.

Bahar Alaeddini is a Senior Associate at Harris Hagan and specialises in all aspects of online and land-based gambling law. She advises major B2C and B2B operators, start-up operators, investors and financial institutions. Bahar advises clients on licence applications, investor due diligence, compliance issues, Gambling Commission requirements and investigations, voluntary settlements and Panel reviews. She is a member of the International Association of Gaming Advisors.