

2011

“Jeux en ligne” in the French Market

Key features, strengths and weaknesses of the
French legal gaming offer

MAG

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EXECUTIVE SUMMARY

In May 2010, French authorities issued a new regulatory framework – Law no. 476/2010 – for online gaming, which introduced new online gaming products (poker, sports betting and horse betting) and opened the market to competition based on a system of public licenses awarded to selected operators.

In taking this path, France is attempting to ensure the protection and safety of players and to curb the black gaming market by setting up technological barriers and imposing severe fines on operators who do not comply with the law.

To achieve these purposes, however, it is necessary to draw players out of the black market into a regulated market provided by licensed gaming operators. This can only be done by making the legalized offer just as appealing to customers.

Currently, the French legal gaming line-up consists of the following games:

- poker, both the cash and tournament version;*
- sports betting, both with fixed-odds and as pools, organized according to the schedule defined by the Autorité de Régulation des Jeux en Ligne (ARJEL);*
- horse betting, only in the pool version, organized according to the schedule determined by the Ministry of Agriculture;*
- lotteries, including traditional lotteries, scratch cards, draws and number games, are assigned to Française des Jeux (FDJ), a state-owned company that manages these products as a monopolist. These products are not regulated under Law no. 476/2010.*

Unlike lotteries, which are subject to a monopoly, the first three product groups can now be offered under licenses.

Taking only the segments regulated by Law no. 476/2010 into account, the official online gaming turnover totaled approx. € 5.3 b in 2010, whereas it had amounted to a mere € 0.7 b in 2009. This boom came about as a result of the market opening and was reflected primarily in the excellent performance of cash poker, which makes up about 69.4% of the overall market. The relevance of the other segments is far lower (poker tournaments have a market share of 7.7%, horse betting a market share of 13.9% and sports betting a market share of 9.0%).

One reason for the popularity of cash poker can be found in the structure of the supply chain; the high tax rate on betting, in particular, (8.8% on sport bets and 14.4% on horse bets, in 2010) considerably reduces the payout, which, with these two gaming products, is further capped to 85% of the turnover.

The response to the official market data ranges from enthusiasm about the high turnover (especially in poker) to dissatisfaction with the betting performance. The same response can be observed in the assessment of the black market. The black market was valued at around € 13.4 b in 2010, implying that the legal offer (12-month forecast) represents only 43% of the overall turnover (€ 23.6 b). Migration to the legal market is lower in sports betting (25%).

There are several factors that help to explain this assessment of the current situation of the gaming market in France.

Firstly, limitations to the product portfolio make efforts to curb the size of the black market less effective and discourage gamers from migrating from unlicensed websites to .fr websites. This

is true particularly for horse and sports betting, whereas the .fr poker offer looks competitive against the black market line-up.

In addition, high taxation on betting products may prompt the black market to grow due to poor business profitability. In order to encourage competition and reduce black market turnover, it appears necessary to adopt a more intelligent taxation system that allows authorized operators to field a competitive line-up of offers that achieves sustainable profitability.

As for technological issues, the French regulation defines a module for gaming transaction control – known as "Frontal" – which ensures player protection, transparency and reliability. The effectiveness of this transaction control appears to have been overestimated, since experience in other regulated markets (such as Italy) has shown how difficult it is to prevent Internet-based business by blocking access to online offers. Controls need to be accompanied by product appeal initiatives in order to create conditions that will allow a competitive .fr offer to develop.

In sum, experience in the regulated markets – as in Italy, France and UK – has shown that, in order to implement a legal and responsible online gaming market that protects customers and tops black market offers, public authorities need to take a balanced mix of measures involving the introduction of a sustainable and business-oriented tax regime, the fielding of an attractive gaming line-up as well as the use of effective (rather than expensive) technology barriers. Any regulated framework grounded on only one of these elements will most likely be unable to effectively outplay the black market offer in the short and medium run.

1 The French regulatory framework for online gaming

1.1 The objectives of the regulation in comparison with those of other countries

Over the past five years, the international online gaming market (i.e. via the Internet, iTV and mobile phone) has seen strong growth and high turnover, and as a result, higher revenues. Given the economic and social relevance of this phenomenon, several countries have been undertaking regulatory efforts to ensure "controlled" growth in various gaming segments and to contain black market gaming. The most important among these are: Italy, which introduced a regulation for betting and instant lotteries in 2006, followed by a regulation for horse racing in 2007 and a regulation for tournament poker in 2008; the UK, a pioneer in gaming regulation, Poland and Greece, which are soon to adopt an online gaming regulation, Spain, which initially adopted the regulation for sports betting in several autonomous communities and has now tabled a draft for a national online gaming regulation, and, more recently, Denmark, which reformed the whole gaming sector, and Romania, which adopted a regulation for online gaming.

In France, the online gaming framework was established by Law no. 476 / 2010¹ which regulates both the expansion of the online product portfolio and its opening to competition.

This new legal framework aims to create a "regulated" gaming industry in which clearly defined rules apply, assuring gamer protection and safety, as stipulated by article 3 of Law no. 476/2010, which sets forth the specific goals of the regulation as follows:

- *preventing compulsive gaming and protecting minors;*
- *preventing money laundering and fraud;*
- *containing black market;*
- *developing different gaming segments in an equitable and fair way.*

This regulation defines the general framework for customer protection and the public order as it provides both legal constraints to reduce gaming turnover (since gaming is still considered a social vice) and tools to control the black market offer.

Regulatory constraints intended to limit the black market may also have an impact on the sustainability of licensed businesses.

Experience in other European countries, like Italy, but also Germany, has shown that there are no all-embracing effective means to control and curb the black gaming market. All the technical measures currently in place – i.e. the blocking of black market websites, bans on advertisement for unauthorized operators, the blocking of financial flows between black market websites and their customers, administrative and criminal sanctions, etc. – are only effective to a limited extent, as shown by Italy where unlicensed (in Italy) operators are still able to generate profits².

¹ LOI no 2010-476 du 12 mai 2010 relative à l'ouverture à la concurrence et à la régulation du secteur des jeux d'argent et de hasard en ligne

² See Financial Statements and business analysis of several unlicensed companies or providers of unlicensed gaming companies in Italy (PartyGaming – before obtaining the Italian license – Bet365, SkySport365, as well as several

Under the assumption that customers would prefer a legal offer for their gaming experience, the State should offer an alternative approach to curb the black market by fostering the formation of a competitive and economically sound legal industry that is able to compete against unlicensed operators and win back an ever larger customer share from the black market.

Finally, if unlicensed websites continue to generate profits in regulated markets (as argued above), then the crackdown on the black market line-up, as implemented in Italy or Germany, is indeed inadequate to ensure that only a legal offer is in place.

In order to curb the black market and irresponsible gaming, it would therefore be expedient to take the following set of coherent measures:

- a) offer a comprehensive, innovative, traditional and appealing product portfolio that is able to satisfy the needs and preferences of gamers;
- b) define specific tools in order to promote “safe and responsible gaming” and limit the effects of “irresponsible gaming”; by way of example, these should include a gaming ban for minors, a gaming ban for specific segments of the population, the setting of limits, the introduction of policies that aim to inform and make customers aware of the legal line-up;
- c) introduce mechanisms to reduce the costs of entertainment for gamers (i.e. given the amount spent, a higher payout would increase entertainment time and improve the gaming experience for customers);
- d) define a tax system that allows licensees to offer a gaming product line-up that would attract customers from unlicensed sites to the regulated market.

In this scenario, coercive tools to curb the black market could be implemented to help achieve the goal of legalizing the online gaming market. The fact that an unlicensed online gaming offer continues to exist within regulated markets, however, shows that wherever these coercive tools have been implemented (i.e. Italy and Germany) they have proved insufficient. In order to effectively contain the black online gaming market it would thus be necessary to put in place a policy aimed at the efficient development of the legal offer and the promotion of a “safe gaming culture”, to protect the last and weakest link in the supply chain, i.e. the gamer.

1.2 Features and size of the French online gaming market

1.2.1 Product portfolio architecture

Previously, black market products were authorized by the French State by virtue of Law no. 476/2010. In particular, this law permitted online gaming products where the result depended both on skills and chance³. A dedicated agency (ARJEL) was set up to govern the legal online gaming market⁴. The French regulation provides that all permitted online games, except for lotteries, may be commercialized by all operators who hold a specific official authorization issued after they demonstrate compliance with specific requirements regarding their reliability as well as their economic and financial solidity

casino games and cash games providers) which either report revenues from regulated markets or make no reference to the fact that operations were closed in regulated markets.

³ See article 2, Law no. 476/2010

⁴ See article 34, Law no. 476/2010

(article 15, Law no. 476/2010).

The current online gaming portfolio is limited to four segments: sports betting, horse pools, poker⁵ and lotteries.

This line-up only partially latches onto consumer needs, not only because some of the more successful online products, such as casino games, bingo and skill games, cannot be offered, but also because parts of the regulation, such as the parts governing taxation and the payout cap, hamper the competitiveness of existing products.

Below you will find a brief outline of the different segment features, as well as the specific games belonging to each of them.

Legal online game segments in France

- *Sports betting. These bets are defined by article 12 of Law no. 476/2010, which permits all operators previously authorized by ARJEL to sell sports bets both in pools and with fixed odds.*

ARJEL itself sets up the schedule of events for which betting services can be offered⁶, by defining the sports, competition categories and results. By "competition categories" the regulator is referring to broader sports events that consist of specific competitions, while "result" means the event's outcome.

Although the range of permitted sports is rather broad and heterogeneous⁷, some kinds of results, and in particular the "handicap", are not included in the ARJEL schedule. This affects the scope of the line-up and competitiveness. Authorized operators can propose modifications to the list of events, but such proposals need to be examined and approved by ARJEL.

- *Horse betting. These kinds of bets are defined by article 11 of Law no. 476/2010, which, just like sports bets, also permits all operators previously authorized by ARJEL to sell horse bets.*

Only the pool version is permitted by the French regulator. Horse racing pools help to strengthen the perception of transparency and reliability in a game segment that has all too often been vilified as a deviant phenomena backed by powerful protectionist lobbies⁸.

In terms of horse betting, French authorities also decided to establish a schedule of competitions and results. From these, approved operators can pick individual events to configure their offer.

This schedule is set up by the Ministry of Agriculture, which approves a list of events proposed by the Fédération nationale des courses françaises⁹. Operators wishing to broaden the schedule can file an application with the Ministry of Agriculture including a description of the event they want to include in the schedule. The Ministry is obliged to

⁵ See articles 10-14, Law no. 476/2010

⁶ See Decision no. 2010-009, May 28th 2010, later integrated by decision no. 2010-058, June 25th 2010

⁷ Currently, the approved sports are: athletics, motor sports, badminton, baseball, basketball, pool, boxing, football, rowing, cycling, horse racing, golf, handball, ice hockey, judo, swimming, volley, skating, pelota basca, rugby, fencing, ski, sport boules, taekwondo, tennis, table tennis, sailing.

⁸ "Rapport d'Information n°58", Trucy, November 7th, 2006

⁹ See article 3, Decree no. 498, May 17th 2010

decide within one month from submission of the application¹⁰.

- **Jeux de cercle.** These games are defined by article 14 of Law no. 476/2010 and by Decree no. 723/2010. The former allows for authorized operators to offer this kind of games, while the latter defines the typology and rules of the games.

Currently, jeux de cercle are limited to poker. Both cash and tournament versions are permitted, as well as its main typologies (Texas Hold'em limit, Texas Hold'em pot limit, Texas Hold'em no limit and Omaha 4 high pot limit).

Permitting tournament and cash poker is definitely a move that distinguishes the French experience from the Italian experience, where as a first step only tournament poker was permitted¹¹. However, it is clear that the jeux de cercle category is incomplete, since key products, like casino and skill games, are missing. Nevertheless, it appears likely that this segment will grow on account of the generic label it has been given. The name "jeux de cercle" sounds as if this category was intentionally given an "open" name. Moreover, the process of defining which specific games belong to this category is certainly more flexible and quicker than the legislative one.

- **Lotteries.** They are subject to a different regulation from the one characterizing the online gaming segments previously outlined¹². In fact, this segment, which is made up of several products (traditional lotteries, scratch cards, draws, number games and sport pools) is assigned to Française des Jeux (FDJ), a predominantly (72%) State-owned company¹³. Since the agreement with FDJ does not make distinctions between the online channel and traditional retail, FDJ has been developing its online business since 2007, without being formally authorized to do so.

1.2.2 Market size

The legal online gaming market in France has been experiencing a considerable surge since June 2010. This growth is attributed to the rise in the number of authorized operators as well as the broadening of the product portfolio, which now includes new gaming segments (jeux de cercle)¹⁴.

¹⁰ See article 3, Decree no. 498, May 17th 2010

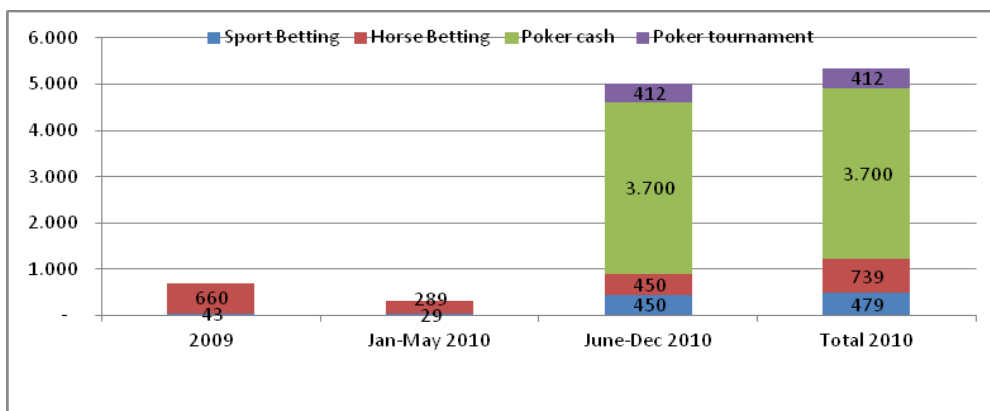
¹¹ Italian regulation, decree of the Minister of Economics, Sept 17th 2007

¹² FDJ was established in 1979 by Decree no 78-1067, and the contract with the state was signed in the following year. The contract tasks FDJ with designing, developing and selling gaming products related to lotteries and pools.

¹³ FDJ Annual Report 2009

¹⁴ See articles 10-14, Law no. 476/2010

Figure 2 – French online legal turnover 2009-2010 (million euros)



Source: ARJEL and operators' data

Considering only the segments regulated by Law no. 476 of 2010, which excludes lotteries still offered under the FdJ monopoly in 2010, online gaming turnover amounts to some € 5.3 b, whereas it totaled less than one billion in 2009 (€ 0.7 b)¹⁵.

The rise in online turnover can mainly be attributed to the introduction of poker, which currently accounts for about 77% of total turnover. Within the poker line-up, the cash version, which generates about 90% of turnover, is definitely the one that consumers prefer, while demand for tournament was marginal.

In terms of horse betting, global turnover in 2010 is estimated to be only 12% higher year-on-year. This positive yet limited growth tallies with the regulatory framework currently in place in France. In fact, although the horse betting market has been opened to new operators, Pari Mutuel Urbain (PMU) continues to be the *de facto* "monopolist", managing a single totalizer for both the stakes coming from online and land-based operations. Likewise, there is little room for other players to respond and to generate a competitive environment.

Sports betting is estimated to have grown dramatically in terms of turnover, rising from around € 43 m in 2009 to some € 480 m in 2010. Although it benefited from the South Africa Football World Cup and the opening of the market to several operators (one month before poker), reports¹⁶ suggest that growth in this segment is rather low compared to expectations. This limited performance is mainly due to the high taxation rates, which have affected investments in product development and advertising. Moreover, licensed operators claim¹⁷ that the gaming tax regime has made it harder to provide a sustainable and appealing legal line-up in terms of odds, which is in no way comparable to the line-up offered by international websites. As a consequence, it appears that the black market offer continues to be available in France, with a negative impact on the system as a whole and on gamer safety (see Ch. 3 below for an overall estimate).

¹⁵ MAG estimation on ARJEL data

¹⁶ « Les sites de jeux en ligne n'ont pas rafflé la mise », Le Figaro on January 14th 2011; « Le faible développement du marché des jeux en ligne en France », Francis Merlin, January 21st 2011

¹⁷ Interview with Stephane Courbit, Le Figaro, Nov. 28th 2010; « Les sites de jeux d'argent en ligne n'ont pas rafflé la mise », Le Figaro, Jan. 13th 2011

1.2.3 Turnover breakdown and value chain

According to the current regulatory framework, the online gaming turnover is shared by three main actors:

1. gamers, in terms of payout,
2. the State and other public administrations, in terms of taxes,
3. and licensed operators whose margins consist of turnover, once winnings and taxes have been deducted.

At the end of 2010, total turnover, which is expected to amount to approx. **€ 5.3 b**, can be broken down as follows¹⁸:

- winnings: approx. **89.9%**;
- taxes: approx. **4.8%**, with taxes making up **4.1%** and other fees payable to public bodies making up some **0.7%**;
- operators' margins: approx. **5.3%** (over € 300 m).

However, the turnover breakdown follows different patterns, depending on the specific product and the role and activities carried out by the respective actor.

The turnover sharing calculation must take into account that 2010 was defined by two different regulations: the one existing before June 2010 and the new one that came in force with Law no. 476/2010. These two regulatory systems provide for two completely different turnover breakdowns, in terms of payout, taxes and margins for operators. Table 1 below presents the 2010 turnover breakdown for each segment.

Table 1 – Expected turnover breakdown 2010

Segment	Turnover breakdown 2010 (%)			
	Cash poker	Tournament poker	Sports betting (new regulation)	Horse betting (new regulation)
Tax	1.2%	1.8%	7.5%	6.4%
Payout	96.6%	88%	79%	76%
Other	-	-	1.3%	8%
Operators	2.2%	10.2%	12.2%	9.6%

Source: MAG estimate based on ARJEL and operators' data

As for **sports betting**, article 3, Decree no. 605, June 4th 2010, limits the maximum payout to 85% of turnover. Actually, this percentage does not only apply to the payout as such, but to any amount the gamer can make use of (bonus, promotions, added winnings, etc.).

In 2010, the average payout made by operators licensed to accept fixed-odds sports bets is assumed to have been around 79% of turnover.

In sports betting, the tax rate is 7.5% on turnover and a further 1.3% dedicated to the Centre National pour le Développement du Sport. The latter levy will be increased to 1.5% on turnover in 2011 and level off at 1.8% on turnover in 2012.

¹⁸ MAG estimates based on ARJEL data

Moreover, the federations organizing the sports events on which bets are placed are entitled to the associated sports rights. The percentage depends on the terms of the contractual agreement between each operator and federation¹⁹. In 2010, it will be around 1% of turnover²⁰. According to ARJEL, operators paid the sports federation some € 530,000 in 2010 (June to December).

The operator's margin can therefore be calculated by subtracting one from the other. Without consideration of the share given to sports federations, the margin will have amounted to approx. 12.2% of turnover in 2010 and it is expected to decrease in response to the competition.

For **horse betting**, too, the maximum payout is limited to 85% of turnover. However, the average payout is estimated to be slightly higher than the one applied by the Pari Mutuel Urbain (PMU) before the market opening (MAG estimate based on operators' data).

Initially, gaming taxes amounted to 7.5% of turnover, with 5.7% going to the Treasury and 1.8% to social security. In addition, between 7.5% and 9% of turnover is earmarked for horse breeding activities.

Once the decree determining the exact percentage payable into the horse value chain had been issued, the tax scheme for horse betting was modified and retroactively replaced by a new one. The share paid to the Treasury was reduced to 4.6% of turnover, while the tax payable to social security remained unchanged (1.8%). Hence, the total tax rate is 6.4% of turnover.

The decree also stipulated that 8% of turnover must be paid into the horse racing value chain, but the French regulator then decided to convert it into a proper tax levied by the State and then devolved to related institutions, France Galop and Cheval Français.

Finally, there is no legal limit to payouts in **poker**, both in cash and tournament poker, which means that operators can decide for themselves. The average payout in the French market corresponds to the rates applicable according to the game formula around the world (96% of turnover for cash poker, as reported by ARJEL, Jan 21st 2011, and 88% for tournaments).

The French authorities only defined the tax rates on turnover: 1.8% for the Treasury and 0.2% for social security. In cash poker, tax rates are applied on the pots with a cap of € 1²¹. Hence, the tax rate for cash poker is 1.2%²².

1.2.4 Market demand: customer profiles and market potential

The French adult population is about 50 million people, 70% of whom declared themselves "not adverse" to gaming, so that the market potential numbers approx. 35 million people²³.

¹⁹ See article 1, Decree no. 614, June 7th 2010

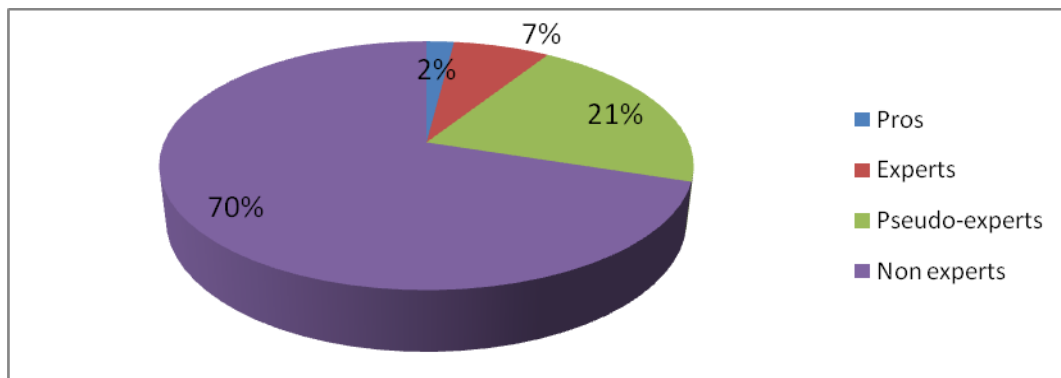
²⁰ MAG estimates based on operators' insights

²¹ See article 302 bis ZJ, Code Général des Impôts

²² ARJEL communication to authors

²³ « JEUX EN LIGNE - Le marché français, peu attractif, possède un gros potentiel », Le Point.fr, June 9th 2010

Figure 3 – Players



Source: Arjel

According to official ARJEL data²⁴, some 2.3 million gaming accounts had been opened and verified and some 1.7 million gaming accounts had been used at least once five months after market regulation. Unique players (active at least once a week) number 500,000. This shows that French people are attracted to the regulated online gaming line-up.

However, these numbers represent only part of all French gaming accounts. A survey conducted by the market research company Médiamétrie²⁵ estimates that about 7.6 million French people were online gaming customers in 2010. By prudentially assuming that most of the online players have more than one gaming account – the Italian experience shows that, on average, customers hold more than 2.5 gaming accounts in more mature gaming segments²⁶ – the number of verified French gaming accounts is expected to treble over the next seven months.

Based on the different spending levels, the customers' profiles can be classified into four typologies derived from a similar taxonomy applicable to the Italian regulated market: *pros*, *experts*, *pseudo-experts* and *non-experts*. The quantitative relevance of each typology is derived from the French market study carried out by Francis Merlin²⁷.

Pros are highly skilled gamers who prefer games with a payout rate of over 95% of turnover (poker, casino games, spread betting, betting exchange, etc.). They account for only a small percentage of the total number of gamers, but they have a substantial impact on turnover. In France, current market research²⁸ estimates that this target group is made up of 500,000 people at most, but they most likely number no more than 100,000. Given their preferences, these gamers are not attracted by the legal line-up as it offers winnings that are far lower than they would expect.

Experts are very skilled too. They like devising sophisticated strategies and seek payouts of about 90% of turnover. Usually their focus is on "simple" sports betting, horse betting or poker cash. The number of experts is definitely higher than that of pros (some 2.5 million). However, the number of experts is expected to rise once higher payouts are available, especially in sports and horse betting.

²⁴ ARJEL, Cérémonie des vœux, Jan. 21st 2010

²⁵ "Les jeux d'argent remportent la mise", Dec. 7th 2010

²⁶ MAG estimations on AAMS and operators data

²⁷ "The effect of illegal sites on the French online gaming market", Oct. 13th 2010

²⁸ "The effect of illegal sites on the French online gaming market", Oct. 13th 2010

Pseudo-experts, of which there are potentially 7.5 million, represent the largest customer category in poker as well as in horse and sports betting. They have a strong preference for "live" products. Unlike the target groups outlined above, pseudo-experts are more ingenuous and exhibit a lower degree of self-control. Although their behavior is more likely to lead to game addiction, pseudo-experts usually generate a smaller per capita turnover than pros and experts.

Non-experts make up the largest share of the online gaming customer base. Usually they like all games where chance is a predominant factor (casino games, slot machines, lotteries, bingo), hoping to garner a big winning that can change their life. It is very difficult to determine the turnover they generate since their spending power is extremely volatile. The current regulated offer in France partially covers the preferences of non-experts.

1.2.5 Supply structure

The regulatory framework adopted by France makes a clear distinction between the "land-based channel", which is still subject to a monopoly, and the online channel, which has been subject to "controlled" liberalization.

The land-based channel is dominated by two historical operators: **La Française des Jeux** (monopolist in lotteries, which includes number games, draws, traditional lotteries, scratch cards as well as sports pools) and **Pari Mutuel Urbain** (which offers horse pools in retail outside race tracks; only Pari Mutuel Hippodrome is allowed to collect stakes inside race tracks, but it has a very low turnover). Moreover, there are several land-based casinos that also have slot machines.

With regard to the online channel, Law no. 476/2010 created a regulated market for jeux de cercle, sports betting and horse pools. However, lotteries are still a monopoly under the control of Française des Jeux.

For all the other online games permitted, the French regulator decided to install a public authorization system. In this system, any company wishing to offer poker, sports bets or horse pools can apply for a license that gives them the authority to collect stakes through their .fr website. These licenses are issued by the competent agency – ARJEL – which also verifies whether the applicant meets all the requirements stipulated by the law²⁹. This system combines the need of gamer protection with a higher degree of market freedom and competition, since no limit is imposed on the number of authorized operators³⁰.

Licenses issued by ARJEL are specific for each segment (jeux de cercle, sports bets or horse pools). All three licenses can be obtained by one and the same operator, they are neither transferable nor negotiable, and they expire after 5 years but can be extended for another 5 year period³¹. License fees are payable on an annual basis and calculated based on the number of licenses issued (annual fee: € 20,000 for one license, € 30,000 for two and € 40,000 for three)³².

Since the opening of the market (up to Dec. 31st 2010), ARJEL has issued 48 licenses to 34 operators. Among them only four (Betclik, Pari Mutuel Urbain, Unibet and

²⁹ See article 34, Law no. 476/2010

³⁰ As it has been implemented in the Italian regulation by Law no. 88/2009

³¹ See article 21, Law no. 476/2010

³² See Decree no. 494, May 16th 2010

Eurosportbet) have all three license for online games.

Twenty-six operators having applied for and obtained a license for online poker and many of them are specialists, offering only this specific product. In contrast, only 16 licenses have been issued for online sports betting. In most cases (11), the operators hold licenses for other products, too (poker or horse pools or both of them).

Finally, 8 licenses have been issued for horse betting. Approved operators in this segment are usually highly specialized in horse betting, like PMU, Zeturf and Geny.

Table 2 – French licensed companies and the authorized gaming products

	Operator	Poker	Sports Betting	Horse Betting	Total
1	Betclic	x	x	x	3
2	Beturf			x	1
3	Bwin	x	x		2
4	Everest	x			1
5	FDJ	x	x		1
6	FrancePari		x		1
7	Chili	x	x		2
8	PMU	x	x	x	3
9	Sajoo	x	x		2
10	Eurosportbet	x	x	x	3
11	Winamax	x			1
12	PartyGaming	x	x		2
13	Friendbet		x		1
14	Partouche	x			1
15	Pokerstars	x			1
16	888	x	x		2
17	SFJI	x			1
18	Geny			x	1
19	Zeturf		x	x	2
20	Jeux 365		x		1
21	LBPoker	x			1
22	Ad Astra	x			1
23	PKR	x			1
24	Rekop	x			1
25	Betnet			x	1
26	JOA	x	x		2
27	Tranchant	x			1
28	Casino du Golfe	x			1
29	Intralot		x		1
30	Unibet	x	x	x	3
31	Titan	x			1
32	Winga	x			1
33	Scale	x			1
34	Fullfun	x			1
	Total	26	16	8	48

Source: ARJEL website data (December 2010)

1.3 The black market offer in France: market size and contrasting measures

This paper defines the black market as including online gaming offered both by companies without any sort of license and by gaming operators with some kind of authorization issued in a foreign country (European or not) that allows them to operate outside the country's borders (but whose license is not applicable in country regulation).

Currently, because of the poor means available for identification, it is not easy at all to quantify the size of the black market. Existing estimates lack any strong empirical foundation due to the difficulty in finding reliable quantified data on this phenomenon. Usually, the estimates are based on indirect calculations using data derived from the controls carried out by official authorities or information provided by operators in their financial statements.

Currently, black market websites are estimated to number about 15,000 and approx. 10% feature a French language version³³.

In an interview published in December 2010³⁴, ARJEL President Jean-François Vilotte stated that, prior to Law no. 476/2010, the black market had made up around 96% of the overall market, which in turn was valued at around € 1 billion. Vilotte pointed out that, from June to November 2010, about 90% of online gaming shifted from the black market to the legal market, reducing the former to a mere marginal factor.

This thesis has been dismissed by several licensed operators who consider it too optimistic, at least for several gaming segments³⁵. Some of them believe that legal websites in France account for only 30% of total online turnover, because the regulatory framework is too tight and covers only some of the gaming products, leaving out important games like casino games and bingo³⁶. According to others, the stakes placed on authorized French websites make up between 30% and 40% of overall online gaming³⁷.

The table below provides an estimate of the size of the overall French online gaming market in 2010, including turnover generated by both authorized and unlicensed websites, on the basis of: official information on French legal market³⁸, statements made by the main gaming operators in Europe and experience from other countries, incl. Italy.

This estimate is based on the following assumptions:

- 1) the demand for online gaming includes not only demand for regulated products but also for games still outside the legal portfolio (casino games, bingo, etc.);
- 2) the turnover on .fr websites is estimated on an annual basis using official data³⁹;
- 3) the gaming portfolio mix – based on GGR – is based on the adjusted H2GC estimates concerning the global spending share of the French market⁴⁰;

³³ "The effect of illegal sites on the French online gaming market", Francis Merlin, Oct. 13th 2010

³⁴ « Selon l'ARJEL, le marché des jeux en ligne est devenu légal à 90% », www.lepoint.fr, Dec. 9th 2010

³⁵ « Les sites de jeux en ligne n'ont pas raflé la mise », Le Figaro on January 14th 2011

³⁶ Interview to Stéphane Courbit, Le Figaro, Nov. 28th 2010

³⁷ Interview de Carlo Costanza (bwin): "Le marché noir compte encore pour 30 à 40%, sinon davantage", IGAmagazine, Dec. 7th 2010

³⁸ ARJEL, Cérémonie des vœux, Jan. 21st 2010

³⁹ ARJEL, Cérémonie des vœux, Jan. 21st 2010 ; MAG estimates based on FDJ Annual Report 2009

⁴⁰ The H2GC was published in February 2010 and provides 2009 data

- 4) the above-mentioned adjustment takes into account changes resulting from new customers who had previously not played on black market websites⁴¹;
- 5) payouts include the poker payouts declared by ARJEL adjusted to take into account the rates applied worldwide by unlicensed operators⁴²;
- 6) poker has been affected only marginally by the black market: the assumption is that merely 5% of the turnover is still generated on black market websites since regulation do not significantly constrain the licensed offer;
- 7) total GGR – which includes both unlicensed and .fr websites – has been estimated based on official poker data. The GGR of the other games has been estimated based on the French mix (see points 3 and 4).

Table 3 – Total size of the French online market

Games	The French Online Market 2010						
	Global GGR %	French GGR %	€ / m (12 month forecast)			Black market rate %	% PAYOUT
			Total GGT	Black market GGT	.fr GGT		
Poker	19%	22.4%	8,635	411	8.224	5%	96%
Sports betting	21%	23.9%	3,603	2,703	900	75%	90%
Horse betting	16%	19.7%	1,479	740	739	50%	80%
Casino games	21%	16.2%	6,107	6,107	-	100%	96%
Lotteries	10%	7.7%	1,662	1,280	382	77%	93%
Bingo	8%	6.2%	1,329	1,329	-	100%	93%
Skill games	5%	3.9%	831	831	-	100%	93%
Total		100%	23,646	13,401	10,245	57%	-

Source: MAG estimate based on ARJEL, F. Merlin and H2GC data

According to this estimate, total online gaming turnover generated by French customers was approx. **€ 23.6 b** in 2010. This includes both authorized and unauthorized websites.

Only part of the total online turnover is legal. In fact, when looking at the online legal market - including lotteries - on an annual basis, **the share of legal turnover makes up around 43% of the total market**, which encompasses poker, sports betting, horse betting, casino games, lotteries, bingo and skill games.⁴³

The relevance of legal gaming becomes more critical when we draw a comparison solely

⁴¹ The sharing between authorized and unauthorized has been defined by using the following data:

- 2.3 m definitive gaming accounts (ARJEL),
- 600 k poker gaming accounts on .com websites – most of them moved to licensed offer (Merlin),
- the total number of gaming accounts for sports and horse betting has been deduced from overall ARPU on betting (about 19% of the turnover) and average ARPU estimates (300 euros),
- the total number of gaming accounts for betting are split into black market and .fr websites in accordance with the same rule that applies for poker; in this latter case, accounts have not been fully legalized

⁴² MAG estimate based on international operator data

⁴³ MAG estimation based on ARJEL and H2GC data

with the total turnover generated by products governed by Law no. 476/2010 (poker, sports betting and horse pools). In this case, legal turnover makes up 72% of total turnover⁴⁴.

These figures are promising, given that the legal market in France was not launched until June 2010. However, it is clear that even if the current regulation ensures a decline in demand for unlicensed online gaming, the latter continues to be sizable.

In fact, when we compare the total turnover of each gaming segment with the turnover of legal gaming, the difference is significant.

The "black market rate" is not consistent across the different gaming segments. Sport betting is the segment with the estimated highest rate of black market (75% of total turnover).

Though it is more balanced, horse betting, too, lacks in competitiveness, since more than 50% of its turnover is on websites not authorized to operate in the French market.

Apparently, only poker achieved what the new regulation intended to achieve.

1.4 Guidelines for an effective regulation and containing black market

Data on the regulation of gaming markets in other countries (such as Italy) reveal that, for lack of a legal market that is more attractive than the black market, the following scenarios may result:

- there is a risk of gamers being attracted to the black market line-up if improvements in the legal line-up are not implemented in the medium term;
- licensees adopt policies that are geared towards the limitation of costs in order to maintain margins, since the regulatory and tax constraints make it harder for them to adopt strategies that increase turnover (including the gamers' pull from the black market);
- the number of companies investing in the legal market is small, due to low profitability and the limits that apply to the gaming portfolio. They continue to operate in the black market.

In order to prevent this scenario and its potential consequences, the upcoming sections of this report argue that the following actions and arguments need to be closely scrutinized:

- a) gradually adjusting the gaming products to meet gamers' demand (see Chapter 2);
- b) defining a tax system that combines the protection of gamers with the protection of the public order by creating a sustainable legal gaming industry that is able to measure up to competitors offering their line-up of games in an irregular or a completely black market (see Chapter 3);
- c) guaranteeing an adequate level of competition (each product should be offered by several competitors) by establishing an appropriate regulatory framework that aims

⁴⁴ MAG estimation based on ARJEL and H2GC data

to (see Chapter 3):

- ✓ regulate the entry of operators in the market;
 - ✓ ensure an ongoing monitoring of the conduct of gaming operators;
 - ✓ provide customer protection;
 - ✓ define criteria for a breakdown of turnover that is able to maintain just the right balance between winnings, tax revenue and operator profits;
- d) providing a high degree of safety and control over gaming operations in order to prevent ludopathy, money laundering and fraud, as well as a structured monitoring of unlicensed gaming (see Chapter 4);
- e) effective communication on legal gaming (how to access, its mechanisms, its advantages, etc.) (see Chapter 5).

The following sections are structured as "Q&As" in order to provide a close analysis for each topic. They place a focus only on the aspects in the French regulation that do not allow effective management of the online legal gaming industry in order to set off unlicensed gaming and ensure protection of customers.

2 Aligning gaming products to gaming demand

2.1 What impact do limitations to the product portfolio have on the size of the black market?

The gaming regulation experience in Italy shows that a significant share of current gaming demand will shift its focus to the legal line-up if the gaming experience offered by the legal line-up is comparable with that of the unauthorized line-up, or even if it is perceived as better due to the higher standards of customer protection ensured by websites regulated by the State.

Today, most EU member states impose restrictions on online gaming line-ups. These restrictions range from a "regulated opening" in Italy and France to proposed regulation in Denmark, Greece and Romania and a "regulated closing", like in Germany and the Netherlands, and give rise to largely incomplete product portfolios that provide a less enjoyable gaming experience that is outmatched by the black market offer. This, in turn, reduces the turnover and profitability of gaming operators, triggering a hidden incentive for gaming operators to remain in the unregulated market as long as it attracts more customers than the legal market.

Once these conditions have been established, the legal gaming industry becomes unable to attract customers from the unregulated international market to the legal gaming line-up and to educate new customers to use the legal offer. This is confirmed by the persistence of the black market offer in countries like Italy where a regulation is in place but does not cover all the gaming product segments.

France began to regulate its online gaming market only recently and several initiatives still need to be implemented. The regulation in Italy, as a leading example of gaming regulation in Europe, can be used as a source for insights and to identify mistakes that need to be avoided in the French regulatory experience.

The Italian online market reached a significant size in 2008 when tournament poker was included in the legal gaming portfolio (the legal offer was launched in September 2008). Before 2008, only betting and lotteries - the latter under a monopoly regime only - were allowed under the license scheme defined in article 38, Decree no. 223/2006.

After two years, despite several attempts to enforce the gaming regulation and prevent the dissemination of the black market offer (black market site monitoring, website bans, etc.) in October 2010, there is still evidence of a black gaming market in Italy. Based on the control activities carried out between January and September, AAMS reported that gross turnover on black market sites was approx. € 3,100 m (approx. € 260 m monthly). In spite of the growing size of the legal market – which reached € 4.826 m in 2010, avg. € 408 m monthly⁴⁵ – the size of the black market still appears to be highly relevant, corresponding approx. to 64% of the size of the legal market.

The size of such a presence shows what repercussions an incomplete legal offer can have (a line-up without cash games and casino games and with serious limitations to the betting program, especially live betting, and the lottery offer). In particular, an incomplete legal offer is unable to attract customers from the black market websites. From this perspective, expectations are that the size of the black market in Italy will

⁴⁵ As officially reported by AAMS, Jan. 18th 2011

shrink once cash and casino games are launched and the next initiatives applying Law no. 88/2009 are implemented in 2011.

Five months after the regulation of the French online gaming market, the size of the black market was estimated to make up approx. 57% of the total gaming market (see Section 1.3) and consisted of betting, poker, casino games, lotteries and bingo. Following our previous line of reasoning, the still significant presence of a black market is due to the continued weakness of the regulatory framework. The decision to apply the regulation to only a small number of games (betting and poker) and the constraints on the betting line-up (tax rates, payout limits, limited betting program, etc...), in particular, impact the effectiveness of any legal market enhancement.

Even if supported by penal sanctions against the black market, initiatives in France aiming to control and repress any unlicensed line-up would not have a significant impact on the reduction of the black market size for the following reasons:

- i) the current black market size is significant due to the gap between the regulated gaming offer, customer demand and the needs of the gaming operators
- ii) the size of the controlling authority (ARJEL has a staff of 20) appears inadequate to carry out ongoing thorough controls.

In sum, any limitation to the product portfolio reduces the impact of initiatives to control and repress. Therefore, limitations on the product portfolio make any efforts to reduce the size of the black market less effective when online gaming is regulated.

2.2 How do constraints on sports betting line-ups affect the size of the black market?

The reasons for any large-scale unlicensed betting line-up mainly lie with the current limitations imposed on regulated sports betting products which render these products less appealing to online players. As stated in Law no. 476/2010, limitations were introduced to ensure customer protection and responsible gaming and to control gaming behavior. However, the measures meant to reduce the potential appeal of the legal offer (to prevent the propagation of gaming as a "vice") may cause the number of French players betting on black market websites to increase.

Regulatory barriers preventing the development of an appealing legal offer are two tiered:

- i. constraints on the betting program, in terms of events and type of bets;
- ii. payout limit (85%).

Constraints on the betting program: The French regulation provides that it is the responsibility of ARJEL to determine the events for which bets are permitted and to define the types of bets permitted⁴⁶. The reason for this regulatory choice is the Regulatory Authority's need to control the betting offer. The regulation identifies neither the events for which bets are permitted nor the procedures for State control/certification of outcomes, which represent the main feature in the Italian

⁴⁶ See articles 2-3, Decree no. 483, May 12th 2010

model⁴⁷ from which the French regulation seems to have drawn its inspiration.

In order to understand the effect of this approach of partial control, it is important to compare the French model with the Italian one. In the latter, on the basis of betting demand and the potential risk of fraud for customers, the Regulatory Authority (AAMS):

- a) defines the list of events on which bets can be placed;
- b) identifies and defines the types of bets;
- c) accepts (by connecting the operators' betting platforms to the State IT gaming system) each single bet placed by the customers on the legal websites;
- d) certifies the outcomes⁴⁸.

In sum, the Italian regulation focuses on the control of the betting line-up as a key aspect of customer protection. On a weekly basis, AAMS selects the events and types of bets, carefully scrutinizing their characteristics. The main selection criterion is: the different stakeholders must have no influence on the outcome. This makes it possible to obtain an objective outcome on short notice.

In any case, the Italian model is far from being effective since it appears to have a detrimental effect on the appeal of the betting offer, leaving a certain latitude for the emergence and development of a black market offer. The growth of the online betting market under the Italian framework, when compared with the French one, shows how a limited betting line-up is able to encourage the emergence of a strong legal offer if it involves tax rates that allow attractive odds.

In the French case, limiting the betting line-up seems only to have leveraged a proliferation of black market bets on unlicensed websites due to the low appeal of the events, bet types and odds in the legal offer.

Along with its constraints on betting, the French regulation introduced a maximum limit for betting payouts – 85%⁴⁹. This is an unusual limit not encountered in any of the leading gaming legislations, incl. the UK, Italy, Spain (offline sports betting). By introducing this limit, the French regulation adopted a means to prevent the growth of the market based on compulsive gaming behavior, which is one of the goals set forth by Law no. 476/2010. Since gaming can be dangerous, the French regulation has set a cap on winnings. However, it needs to be pointed out that a payout cap only limits the growth of the legal market. Paradoxically, it gives the black market a further advantage on the legal offer. The following figure substantiates this argument: the average payout ensuring profitability in French legal betting was approx. 79% in 2010⁵⁰. This payout level is significantly lower than in regulated markets, like Italy, where payout is estimated to be approx. 85%⁵¹. The French payout calculation does not take into account any bonuses won by customers. Hence, the actual withdrawable cash payout is even lower.

In sum, payout limits in France have the following implications:

- a) lower appeal of the legal offer vis-à-vis the black market offer;
- b) management complexity to meet licensees' profitability goals.

⁴⁷ See article 4-5, Decree no. 111, Mar. 1st 2006

⁴⁸ See article 6, Decree no. 111, Mar. 1st 2006

⁴⁹ See article 3, Decree no. 605, June 7th 2010

⁵⁰ « France : Taux de retour aux joueurs inférieur à 80% pendant le Mondial », I-gaming France, July 21st 2010

⁵¹ MAG estimate based on AAMS data 2010

In terms of the first implication, as shown in the Table below, French licensees currently offer odds that are less competitive than those on black market websites and less competitive than those offered by Italian licensees.

The table below compares book %s. Book % relates the odds on a given event in order to identify how far they are from odd=1. We compare three different offers: black market, .it and .fr. The book % index is higher when odds are lower. So higher book % means that odds are less attractive for customers.

Table 4 – Odds comparison (.com/.it/.fr)

Market	Unlicensed	.it	.fr
Avg. book %	108.2	108.2	111.8 – 117.7

Source: MAG benchmark of odds, December 2010

With regard to the second implication, gaming operators need to manage odds in order to meet the maximum payout constraints on a quarterly basis. This may affect the definition of odds and impact competition. By considering bonuses in the payout calculation, gaming operators are also constrained in their definition of commercial initiatives or more aggressive pricing policies. In this sense, gaming operators are prevented from using some of the marketing initiatives to compete with the black market offer.

The constraints on betting products do not appear to enhance customer protection but certainly creates a further competitive advantage for the black market offer, allowing the latter to grow in spite of the development of a legal offer.

2.3 How do constraints on horse betting line-ups affect the size of the black market?

The French regulation allows horse race betting once a specific authorization has been obtained. The aim here is to promote stronger competition for the benefit of customers⁵². The opening of horse race betting, however, has not brought about the expected benefits for customers since PMU continues to maintain a monopoly.

In fact, PMU is adopting a single totalizer for both offline and online horse betting, taking advantage of the unique position it has in the French offline market, which competitors cannot attain, at least at this stage of market development. In this way, PMU is able to offer higher and more appealing prize pools than all the other licensees. As a consequence, PMU has the largest market share.

Given this scenario, constraints on betting actually further reinforce the monopoly. Horse betting is subject to the same limitations as sports betting: maximum payout limit (85%), a pre-determined betting line-up based on the proposal put forward by Fédération nationale des courses françaises and approved by the Ministry of

⁵² See article 4, Law n. 476/2010

Agriculture⁵³. Finally, the lack of fixed odds in the legalized offer⁵⁴ is liable to slow down customers migration to the legal offer.

The above-mentioned conditions cause the regulation to have only a modest impact on the size of the black market. This appears to be confirmed by the growth rate of 12% in 2010 as announced by ARJEL⁵⁵ and the expectations reported by PMU (PMU Annual Report 2009).

Totalization and constraints on betting hamper the emergence of any competitive offers in horse betting. Most of the market continues to be controlled by the previous monopolist (PMU). As a consequence, the existence of a legal market does not provoke any discontinuity to the black market offer.

2.4 How do constraints on poker affect the size of the black market?

The French poker regulation is one of the main strengths of online market regulation. Regulated poker allows gaming operators to set up an offer that meets current demand and complies with current practice.

Under current regulation, the following can be offered:

- i. the most widespread poker games (Texas Hold'em limit, Texas Hold'em pot limit, Texas Hold'em no limit and Omaha 4 high pot limit);
- ii. both tournament and cash poker.

Product appeal is also enhanced by:

- i. no regulatory limitation on payouts;
- ii. the tax regime: 2% of turnover with € 1 ceiling on the pot, resulting in a further decrease of the actual tax rate⁵⁶.

The poker regulation has so far encouraged not only the acquisition of new customers, allowing for massive marketing expenses, but also the acquisition of customers already familiar with unlicensed offers. In fact, the current boom in poker turnover presumably takes its origin in the black market customers looking for an adequate gaming experience since they are supposedly the first to open gaming accounts. Turnover generated by new customers will follow suit and pave the way for the creation of a French poker room offer alongside the international one.

Poker regulation in France is adequate to create sufficient competition between unlicensed line-ups and the .fr offer, encouraging customers to migrate from black market to .fr websites and operators to obtain a legal status for most of the major poker rooms. The size of the black poker market is expected to shrink accordingly.

⁵³ See Decree 2010-498, May 17th 2010

⁵⁴ As defined in Law no. 476/2010

⁵⁵ ARJEL, Cérémonies des voeux, Jan. 21st 2010

⁵⁶ See article 302 bis ZJ, Code Général des Impôts

3 Adequate competition and economic supply-chain balance

3.1 What is the link between taxation rates, business sustainability and black market size?

As there is a lack in thorough economic analysis, evidence from regulated markets like Italy show a positive correlation between high tax rates, low profitability and large black markets. High tax rates, in particular, which were introduced to ensure State control of gaming activities, may end up creating a larger black market. The Italian experience provides proof of this correlation. When lower tax rates were introduced for sports betting, new operators decided to enter the market. bwin, for instance, was the only international gaming operator to enter the market in 2006 (along with Unibet which opted for a turnkey solution provided by an Italian company). Once taxes on betting were reduced, other international gaming companies entered the regulated Italian online market, incl. Betclac and Intralot. In France, the tax rates have recently induced gaming companies like Ladbrokes and Eurosportbet to close down their operations just as William Hill (which is now looking to enter the market again) and Ladbrokes had done in Italy.

These dynamics can be explained as follows using the economic theory on consumer behavior: higher tax rates are meant to affect the market by proportionally decreasing consumption propensity, on the one hand, and reducing supplies, on the other. With gaming, these consequences would apply if only the legal offer existed. Once a black market offers gaming, the impact on demand is manifold:

- a) it reduces the turnover share used for payouts (coeteris paribus);
- b) it increases the cost of entertainment for customers;
- c) it reduces the turnover share allocated to remunerate the supply chain (except for the State).

It can therefore be argued that the tax regime has a three-pronged impact. A) The legal product becomes less competitive than the unlicensed product since the gap between prize pools offered by the legal market and those available on black market websites widens. B) The amortization of marketing expenses is slower due to the low appeal of the legal gaming product. C) Marketing investments are reduced by licensees in response to the lower revenues and to ensure a sustainable financial performance.

In sum, a tax on payouts causes gaming operators to offer a less appealing product to customers. This leads to a reduced gaming turnover, on the one hand, and lower overall profitability, on the other. These two factors justify lower marketing investments for products and communication.

As a logical consequence, the loss in competitiveness on the part of the legal offer and the reduction of marketing expenses is liable to prompt customers familiar with betting to migrate from .fr to black market websites once they discover the appeal of the black market offer. A black market emerges when a legal market is subjected to high taxes and licensees generate only low profitability. Persisting high taxes and low profitability may cause gaming operators to abandon the legal market, giving rise to additional unsatisfied demand which then easily shifts its focus on the black market offer.

Finally, the original goals of the State are not achieved with high taxes and low

profitability on gaming turnover. In this model, the only option available to increase State revenues is to further raise tax rates. However, economic theory again suggests that raising tax rates beyond a certain level may decrease turnover to such an extent that overall tax revenues decrease. In addition, a decline in turnover may imply corresponding growth of the black market.

The correlation between high tax rates, business sustainability and black market size shows how higher tax rates can cause the black market to grow on account of low profitability. Moreover, higher taxes might not generate higher revenues for the State since a large share of gaming demand stays focused on the black market offer.

3.2 Does the product-related tax rate (incl. VAT) affect the size of the black market?

With the exception of cash poker, French regulation introduced a tax regime for the online gaming market consisting of a specific tax rate for each gaming product applicable on turnover⁵⁷.

ARJEL's aim in devising such a tax scheme, as stated in Law no. 476/2010, was to limit the size of the market and to increase State revenues. However, as also affirmed in 5.1, tax effects are more complex and also affect overall business sustainability. In particular, gaming operators can choose from two basic strategies to deal with tax regimes:

- passing taxation on to customers by adjusting (increasing) the "price" (odds level and rake);
- reduce the profits.

With the first strategy, the adjusted odds and rake make the products less appealing than unlicensed products. The effect on new customers is low at the beginning and rises over time due to the customers' gradual acquaintance with the gaming offer. The effect on existing customers (i.e. those already familiar with the .com offer) is faster. A less attractive price stops any migration from unlicensed to .fr sites. As a consequence, it gets more difficult for .fr sites to attract the most profitable customers, those already familiar with gaming.

With the second strategy, overall business sustainability is affected. In order to maintain profitability, taxes are compensated for by reducing other costs, mainly marketing expenses if we go by the recent announcement by French licensees CEOs⁵⁸. Cost downsizing may even lead to a market exit, as recently announced by Ladbrokes and Eurosportbet in France and in Italy and Ladbrokes and William Hill last year in Italy. It can be argued that the resulting smaller market is unlikely to put up effective competition against the black market. On top of that, higher taxes can be offset almost completely through lower income tax revenues and lower turnover.

⁵⁷ Law no. 476/2010

⁵⁸ « Sans changement majeur de la loi cette ouverture sera un fiasco », Interview with Nicolas Beraud, IGA Magazine Jan. 2011

The tax reduction process will have a positive impact on migration from the unlicensed to the .fr offer, on the economic sustainability of the legal gaming industry and on State revenues.

3.3 Is the taxation of betting in France an effective model to create a sustainable market?

According to current French regulation, the tax rate on betting will increase from 8.8% in 2010, to 9.1% in 2011 and 9.3% in 2012⁵⁹. It is important to find out whether this tax level will promote the emergence of a sustainable gaming market in France in the short to medium term and whether it will be able to ensure effective competition with the black market offer.

Most of the arguments put forward in 3.2 also apply directly to the betting tax regime in France. High taxation affects business sustainability because of the existence of a black market ready to offer competitive products. Sustainability is negatively affected in the medium run. In fact, in the short term, the expenses for the acquisition of new punters may keep profits at operators' business plan levels. However, in the medium run, the amortization of marketing investments will become slower as better customers migrate to the black market and lower-spending new customers are acquired.

High tax rates and an incomplete betting program do not give gaming operators any important strategic leverage to compete against the black market. Licensees end up acquiring new punters, making them familiar with the fundamentals of fixed odds betting and then seeing them migrate towards sites offering better odds, more bets and more bonuses. In the medium run, there is the risk that this process will prompt many bookmakers to leave the French market. Under this framework, only a limited oligopoly of gaming operators would be able to achieve sustainable profitability as expected in Italy due to the increase in costs of competition in the online market.

In the short run, market sustainability is also achieved when high tax rates are in place. In the medium run, the effect of taxation on profitability and the return on marketing investments will ensure sustainability only for an oligopoly of several operators.

3.4 Does a lower tax (i.e. the Italian framework) on betting affect the size of the black market?

The argument that lower tax rates allow for more effective marketing policies, reducing the propensity to play on unlicensed sites, is substantiated by cases where betting taxes have been lowered. The most interesting case is Italy, where betting tax rates were purposefully lowered by article 4, Law decree no. 504, Dec. 28th 1998, as amended by article 38, Law decree no. 233, July 4th 2006, no. 233, art. 38.

From November 2008, tax rates for fixed odds betting reached their lowest level (as envisaged by the law): 2% for bets on up to 7 events and 5% for bets on more than 7 events. In the same year, betting tax revenues reached € 32.9 m with an average tax

⁵⁹Law no. 476/2010

rate of 3.1%⁶⁰.

In 2009, when the new tax rates were applied throughout the whole year, betting tax revenues reached € 31 m, with an average tax rate of 2.5%. At the end of 2010, betting tax revenues are estimated to be € 34 m with an average tax rate of 2.5%⁶¹.

The data confirms that for a mature gaming product (betting in Italy can be considered mature since the market started in 1998 for offline fixed odds bets and in 2003 for online bets) a reduction in the tax rates is accompanied by an increase in betting turnover - which grew from € 1,069.7 m in 2008 to € 1,221.6 m in 2009, attaining € 1.353 m in 2010⁶² - with a growing share of the black market line-ups migrating to legal websites. Based on the official AAMS data, it can be argued that the tax rate reduction paid off in terms of encouraging the migration of punters and bets to the legal sector, helping gaming operators to offer more competitive odds than the black market.

At the same time, the tax rate reduction encouraged new operators to enter the legal market as they benefited from lower taxation. These new licensees included not only international bookmakers which had previously balked at entering a regulated market, but also Italian companies with no previous experience in gaming but betting on the high potential of this industry.

It can be also argued that the reduced tax rate did not boost the profits made by the gaming companies. Official AAMS data on 2010 payouts show a gradual increase in payouts over the last few years. Profits have therefore grown due to the ongoing introduction of new games rather than the decrease in tax rates. In betting, lower tax rates have freed up funds for investment in marketing, including bonus initiatives, and better odds. As economic theory would suggest that a tax rate decrease creates room for an increase in supply.

More licensed operators, better odds, increased turnover, a more efficient offer, all converge in sustaining the argument that lower tax rates create the conditions necessary for the legal market to effectively compete against the black market.

3.5 How does a cap on payouts affect the betting offer?

The French regulation put a payout cap (85%) on betting. The purpose of the payout cap is to reduce the appeal of betting products that prevent high payout rates. The goal is to strengthen responsible gaming and to prevent ludopathy by making the product less appealing on the payout side.

In practical terms, payouts cannot be determined ex ante in the fixed odds betting context. Thus, the only possibility of meeting the 85% limit is to adjust the odds. In order to reduce the potential payout, less attractive odds have to be proposed. Consequently, the payout limit introduces a further element which reduces the attractiveness of odds that can be offered on .fr websites.

It also needs to be pointed out that other regulations do not include a payout cap (UK,

⁶⁰ MAG estimation on AAMS official 2009 and 2010

⁶¹ MAG estimation on AAMS official 2009 and 2010

⁶² AAMS official 2010 data published on Jan. 18th 2011

Italy). In Italy, online betting payouts in 2010 made up 84.3%⁶³, gradually closing in on the French cap. In order to remain within the cap and cope with the higher tax rates, odds in France need to stay well below international standards. Since odds comparison tools are widespread within the punting community (and easily available on the Internet, on websites like, among others, www.oddsportal.com, www.infobet.com), the reduced appeal of the French regulated offer is quickly recognized. As discussed in previous sections, the lack of competitiveness is a major reason for customers to remain on black market websites or migrate from .fr websites to the black market later on.

A payout cap on betting is another element that distorts competitions between.fr websites and the black market. In particular, the payout cap affects fr. odds by reducing their appeal and increasing the gap to black market odds.

3.6 Is the taxation of poker in France an effective model to create a sustainable market?

The current French regulation for poker provides for a 2% tax on turnover in tournament poker and a 2% tax on each pot (with a cap of € 1) in cash poker⁶⁴. The tax rate on cash poker seems to be effective. It has not changed the fees usually applied by poker rooms in the black market.

In terms of poker tournaments, the Italian experience shows how a 3% tax on turnover allows average payouts of approximately 90% and does not distort the market and create conditions for growth. Launched in September 2008, poker tournaments generated turnover of € 3,145 m in 2010⁶⁵. The French tax rate of 2% should create even clearer condition for growth. This is confirmed by the fact that all the main poker rooms applied for the French license right at the start while in Italy some of them still have not joined the legal market (e.g. Full Tilt, Microgaming, 888).

In cash poker, operators have a more difficult time managing the tax level– 2% on pots, with a cap of € 1 – since tax incidence on gross margins (GGR) is estimated to be approx. 35% (markedly higher than the rate envisaged for Italy – 20% on GGR)⁶⁶.

Growth in the poker market, especially poker tournaments, is key for any sustainable online gaming market. In fact, the importance of liquidity for games like poker immediately transforms a small website into a not exciting gaming experience. Therefore, it is crucial to provide a large poker tournament offer in order to acquire customers. If these requirements are not met, customers will face unusually long waiting times before they get to start a sit&go session and small tournaments will be unable to generate large guaranteed prizes. Ultimately, this would give rise to a consumer experience that is inconsistent with international standards.

In sum, the French regulation has adopted a tax regime that allows the development of a competitive poker line-up. It was the only way to have the regulated poker offer accepted by the market; otherwise French poker would have been ignored by customers. This conclusion is confirmed by the fact that, in Italy, poker platforms which were unable to generate reasonable liquidity levels did not downsize their operations.

⁶³ AAMS official 2010 data published on Jan. 18th 2011

⁶⁴ See article 302 bis ZJ, Code Général des Impôts

⁶⁵ AAMS official 2010 data published on Jan. 18th 2011

⁶⁶ MAG estimate based on ARJEL data

Rather, they decided to exit the market. Examples include small Italian platforms as well as large networks like Microgaming that found it difficult to enter the market as latecomers.

In France, taxes on poker are well balanced. This was the only feasible option since a tougher tax regime would have caused regulated poker line-ups in France to disappear. Thus, the goal of creating a counterpoise to the black market would not have been reached.

3.7 Are betting constraints an effective way to prevent corruption in sports?

Another reason to control betting by limiting the betting program is the need to ensure that no bets are allowed on events whose outcomes can be shaped or influenced. This is the argument used in Italy to justify the centralized control of betting programs by the State. In this case, constraints on betting programs represent tools used by the regulators to control corruption, especially in sports that are unable to control their affiliates for the sake of ensuring fairness in the events.

Limiting betting line-ups is not an effective tool to disincentive match fixing and corruption in very popular sports, which attract most of the bets. In these domains, anti-fraud initiatives have been relying on centralized control systems that are able to identify real time irregularities or unusual betting concentrations⁶⁷. These systems have raised the awareness in national and international football and tennis federations, since the reputation of these sports is particularly vulnerable due to the wide media coverage resulting as soon as there is any suspicious outcome. These are the only available tools to effectively protect fairness in sports events, together with a close review of the national regulations on match fixing, even entailing penal sanctions if need be.

Moreover, the control of the betting line-up in no way prevents bets from being placed on events not included in the betting program, since bets can be placed on those events in the black gaming market. Including minor sports in the legal betting line-up may instead encourage the sports federations to cooperate with legal gaming companies and include them in the ESSA early warning system.

In sum, limitations on betting line-ups are meant to protect less popular sports but they actually push gaming demand into the black market. As for main sports events, they do not represent an effective tool for fraud control and the prevention of match-fixing.

⁶⁷ see the recent initiatives by UEFA against match fixing and last week's meetings in Italy organized by AAMS to find a technical solution for the identification of unusual betting on sport events

3.8 What impact do sports rights (and the related increase in betting taxes) have on the effectiveness of anti-black market offers?

The French regulation acknowledges the right of the Sports Federation to charge a fee (representing an average of 1% of turnover) on licensees that promote bets on their events⁶⁸. This is an important step which has no precedent in the many other gaming regulations like that of Italy.

In principle, the relation between bookmakers and sports federations is intended to strengthen the common goal of preventing fraud and match fixing. Actually, this regulation does not appear to be giving rise to any significant consequences. From a financial viewpoint, it is not allowing full sports funding (according to ARJEL, € 530,000 were collected in 2010) and is widening the gap between the French Soccer Federation, which has been earning more since soccer attracts more bets, and other sports federations. Moreover, an unlikely but possible disagreement among a sports federation and bookmakers may make it impossible to include an event in a betting program, widening the gap between the legal and the black market offer. As for the prevention of fraud and match fixing, sports federations consider the agreement between betting companies and sports federations to be a mere commercial tool. The prevention of fraud and match fixing, especially in minor sports, requires sports federations to set up effective anti-fraud units. In order to help minor sports federations, it may prove more effective to have a centralized anti-corruption unit.

Sports funds provided by betting could be more effectively generated by taking the funds from total gaming tax revenues destined for sports funding and managed by the National Olympic Committee⁶⁹. This set-up, adopted in Italy after the collapse of Totocalcio revenue model, has ensured that financial resources also reach minor sports since the most popular sports are capable of financing themselves. Currently, funds for sports in Italy total € 450 million.

The fee charged by sport event organizers is a commercial rather than an anti-corruption tool. Especially for minor sports federations, centralized anti-corruption units might prove more effective, since the commercial fee for sports events organizers could have a negative effect on odds and the attractiveness of legal offers.

⁶⁸ See articles 2-3, Decree n. 617, June 7th 2010

⁶⁹ See article 1, paragraph 282, Law n. 311/2004

4 Market control and safety of gaming transactions

4.1 Which tools ensure customer protection under the French gaming regulation?

According to the French regulation, gaming is still conceived as a "high social risk vice". In this respect, the French online gaming regulation aims to achieve the following priority goals⁷⁰:

- a) controlling and limiting ludopathy behavior;
- b) ensuring the safety and transparency of gaming transactions to prevent criminal activities (fraud, money laundering, terrorist financing...);
- c) ensuring a balanced development of the regulated gaming segments.

Several tools have been adopted to achieve these goals. First of all, in the licensee selection process, ARJEL put in place a very careful procedure to scrutinize each application and all the potentially critical aspects of the gaming company's operations (company ties, business sustainability, website and gaming transaction safety and protection, all the measures to prevent fraud and interaction with criminal activities, ludopathy risk, conflict of interests, IT requirements) in order to warrant that all the licensees are completely reliable and meet the requirements⁷¹.

Secondly, licensees are requested to take specific measures designed to discourage customers from excessive spending on gaming such as alerts on the website, assistance in the event of ludopathy, and the obligation to make available information on the gaming account balance and gaming transactions details at all times. Of course, gaming operators may launch any other initiatives that ensure responsible gaming and customer protection⁷².

Thirdly, in terms of operational safety and protection from criminal activities, the French regulation stipulates that each licensee adopt an IT system, called "Frontal", through which all the relevant customer data and information on customer transactions to and from the gaming platform are passed. The data is stored in an access-safe box which can be accessed only by ARJEL representatives for control purposes. Moreover, all licensees are obliged to submit a certification issued by a third party accredited by ARJEL once a year. Certification confirms the fulfillment of all the requirements under the current gaming regulation.

Finally, if none or not all of the requirements have been met, ARJEL can sanction the responsible licensee as follows⁷³:

- a) issue a warning;
- b) reduce the license's period of validity (of one year);
- c) suspend the license for a period of 3 months;

⁷⁰ See article 3, paragraph 1, Law no. 476/2010

⁷¹ See article 4-11, Decree no. 482, May 12th 2010

⁷² See article 17-20, Law no. 476/2010

⁷³ See article 43, paragraph 4, Law no. 476/2010

d) suspend the license indefinitely.

Each sanction is imposed after a notice period (from 1 to 6 months); during the notice period, the gaming operator is given the opportunity to ensure compliance with the outstanding requirements.

To enforce the law against unlicensed gaming providers, ARJEL representatives and the police are authorized to check and severely sanction any company offering a gaming line-up without the authorization of ARJEL. Sanctions include fees ranging from € 90,000 to € 200,000. Sanctioned companies are prohibited from applying for a new gaming license from ARJEL for a period of 5 years. Tougher sanctions are imposed on individuals involved in unlicensed gaming: suspension of political, civil and family rights, seizure of goods used to provide the black market line-up, confiscation of assets involved in the black market activities for a period of at least 5 years, prohibition of any other commercial or industrial enterprise, disclosure of information on the sanctions. Further sanctions from € 100,000 upward can be imposed on companies promoting or advertising the black market line-up⁷⁴. In 2010, ARJEL requested the ban of 125 black market websites, mainly based on information provided by licensees.

Along with sanctions, the French regulatory authority has defined further incentives to discourage potential customers from visiting black market websites. Among them:

- a) termination of website access, even though the Italian experience has shown how easily this measure can be dodged by medium-to-low Internet users;
- b) blocking of all financial transactions between black market companies and their customers in France, although this potentially clashes with the EU's general principles or can be dodged by using e-wallets, as has been done in the USA.

The French regulation defines many tools for customer protection. However, their effectiveness in preventing the development of a black market line-up has to be assessed; in some cases, when limiting access to black market websites for example, the effectiveness of these initiatives is largely exaggerated.

4.2 How are French controls of technical systems (front-end system, ARJEL approval of software) more or less effective than other control systems (e.g. Italy)?

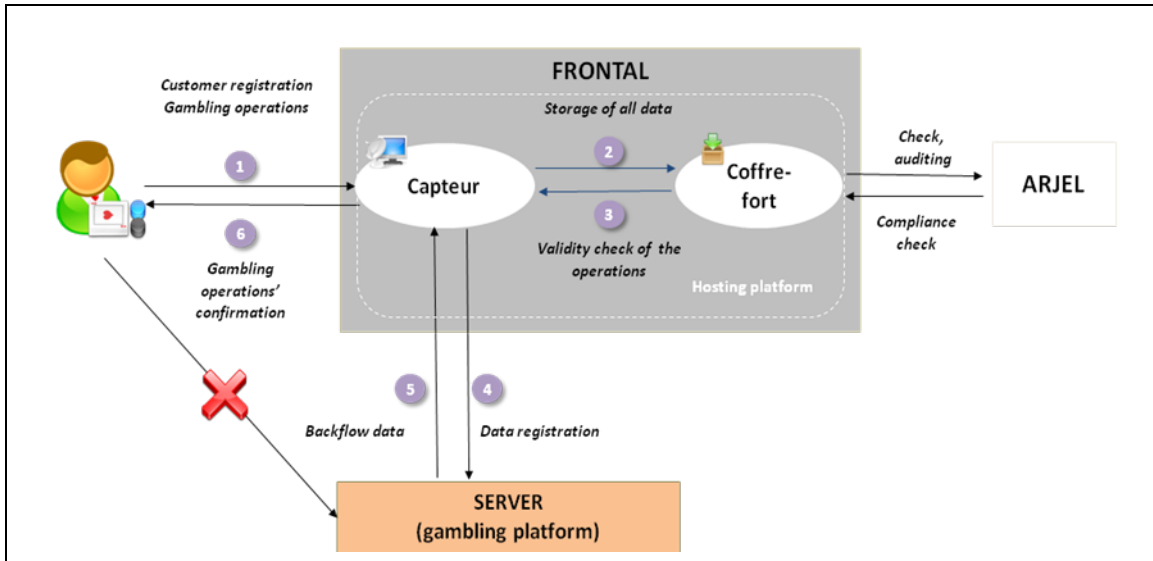
The French regulation governing the control of gaming transactions stipulates that each licensee uses an IT system known as "Frontal" (ARJEL, Cahier des charges). This system consists of a sensor, which captures all the transactions between the customers and the gaming platform, and a box that stores the data so that it can be verified by ARJEL.

The way Frontal works (see Figure 1) is simple when you compare it to the Italian system where licensees are obliged to connect to the AAMS system using complex communication protocols. AAMS also validates and authorizes each gaming transaction in real time⁷⁵.

⁷⁴ See article 7, Decree no. 624, June 8th 2010

⁷⁵ See the decrees authorizing the offer of legal games in Italy

Figure 4 - Front-end



Source: MAG elaboration on ARJEL regulation

However, Frontal effectively ensures the transparency of gaming transactions by tracking, storing and validating the following data:

- a) personal data of the gaming account holder;
- b) gaming transactions on the gaming accounts;
- c) gaming operations;
- d) betting program for sportsbook and racebook;
- e) card drawings by RNG;
- f) customer profiles and their gaming behavior;
- g) promotions;
- h) platform management and malfunctions;
- i) gaming operators' controls, game incidents and identified fraud;
- j) maintenance and evolution of gaming materials and IT infrastructure.

The French regulation has defined a model to monitor gaming transactions which also fulfills the protection requirements by complying with safety and reliability standards.

4.3 Is the French model effective in blocking access to .com websites?

In order to prevent access to unauthorized websites, ARJEL has defined a procedure to ban black market websites active on the French territory. The procedure, described in article 61, Law no. 476/2010, gives gaming operators eight days to comply with the existing regulation. If they fail to comply, ARJEL may request the Paris court to ban the

website. ARJEL may also request that references to the banned websites be removed in the search engines.

The website banning procedure in Italy is different: Internet service providers are requested to re-direct customers trying to access websites that feature on a black list to an AAMS webpage where the reasons for the ban are explained. Today, there are 2,700 banned websites but clicks onto black market websites numbered 525 m between January and September 2010. In spite of the strong effort, it is easy for most Internet users to get around bans by adopting simple procedures.

In France, ARJEL would have requested the ban of 125 black market sites, many of them identified by licensees. However, the application of the law continues to be difficult due to the lack of agreement between ARJEL and the Internet service providers on who is to bear the costs of banning a website. Hence, for the time being, banning in France is a theoretical rather than a feasible option.

The possibility of blocking financial transactions, as inspired by the US "Unlawful Internet Gaming Enforcement Act" (UIGEA) of 2006, has so far not been included in the regulation. As reported above, violators are given a grace period to comply with the requirements. If they fail to comply, ARJEL may ask the Ministry to approve blocking the violator's transactions. The maximum period for any block is 6 months, but it can be extended, and applies to all the banks and financial institutions.

For the time being, the French model appears unable to adopt a clear strategy when it comes to banning black market websites. In this context, customers who see the benefits of an unlicensed offer can easily access these websites. For this reason, the technology requirements defined by the gaming regulation, although easy to comply with, do not significantly affect the size of the black market size.

4.4 How to close accounts on black market websites?

There are two different approaches when it comes to accounts on black market websites. Firstly, the treatment of .com accounts belonging to gaming companies applying for a French license. Secondly, the treatment of .com accounts belonging to gaming companies not interested in obtaining a French license.

The French regulation – in particular, Decree no. 518, May 19th 2010 – stipulates the manner in which licensees are expected to manage gaming accounts throughout their whole life cycle. Applicants are obliged to close their active gaming accounts on black market websites before they obtain their license⁷⁶.

However, some operators believe that it cannot be excluded that some gaming accounts on black market websites have been directly transferred to the .fr sites without following the formal registration process. This procedure does not comply with the requirements under the regulation, but it has been followed by several licensees and has resulted in the following negative effects:

- competitive advantage for licensees that have adopted this practice on those who duly closed their .com accounts before opening the .fr websites;

⁷⁶ See article 24, Law n. 476/2010

- "holes" in ARJEL's control system since the regular registration process is not in place for some customers (those who previously played on .com websites).

The main reason for French operators doing this is in fact that:

- most of the current gaming operators' customer base actually comes from the black market;
- in the operator's perspective, asking .com customers to register again on the .fr website entails a high risk of losing customers;
- the risk of losing customers is raised because of the different steps required under French law for the registration procedure.

In the view of gaming operators, the French registration procedure is too complicated for customers. It seems that, on average, gaming operators lose 50% of the customers who fail to turn their gaming account from "compte joueur provisoire" to "compte joueur définitif"⁷⁷. These customers will likely be attracted to the black market line-up.

It is unclear if the control procedures and resources currently in place allow ARJEL to undertake the necessary efforts to prevent such practices and/or sanction any previous irregular behavior which represents a source of unfair competition in the market.

The gaming accounts registered on black market websites of gaming operators not willing to apply for a French license can be closed by applying the punitive tools against the black market gaming line-up. Nevertheless, it is difficult to act legally against these gaming companies since they are often located in countries that refuse to collaborate. In these cases, efforts (inspections, sanctions, etc.) are not very effective if not leading to license decadence.

Legal procedures to close accounts held with unlicensed operators need to be made more effective in order to strengthen the position of the licensed operators. The best strategy seems to be: A) The definition of an appealing legal offer which gets most gaming companies to comply with the French regulation. B) The simplification of the customer registration process in terms of convenience and the time required.

At the same time, technical measures to ensure that gaming operators follow the legal procedures should be put in place through a dedicated IT team of ARJEL.

4.5 Is the denying access to black market websites on search engines an effective measure?

The French regulation gives ARJEL the possibility of asking search engine operators to exclude unlicensed gaming companies⁷⁸. This provision resembles the provision adopted in the US by UIGEA. However, this would require the agreement of all the search engines operators applying it. Moreover, this provision does not appear to comply with the principles of EU law.

Nevertheless, even if search engine operators agree to remove any links with unlicensed gaming companies, this effort would only partially affect their business since the

⁷⁷ MAG elaboration on operators' data

⁷⁸ See article 61, Law no. 476/2010

websites can be accessed directly. Therefore, only less-known websites would be penalized as the best known sites would continue to acquire clients as in the past.

Any action involving search engines, but also the closure of accounts held on black market websites, is not effective when it comes to expert Internet users. They have to go along with the measures banning access to the black market websites by concluding an agreement with Internet service providers. Even in this case, however, the overall effectiveness of any such efforts is strongly reduced by the difficulty to enforce any limitations on access in the Internet.

5 Effective communication

5.1 How does the removal of advertising restrictions for the legal offer work?

One of the immediate advantages legal gaming operators have on unlicensed gaming operators is the removal of advertising constraints⁷⁹ and, in particular, access to the mass media. In a common regulatory framework (shared by France and Italy and, most likely, other future European regulation experiences) only legal gaming operators are authorized to run advertising campaigns on mass media (press, TV, etc.) in keeping with the general constraints on commercials for products for which advertising to underage consumers is prohibited.

Through mass media visibility, legal gaming operators are given the possibility of building brand awareness which is liable to improve their rate of acquisition of new customers and also encourages customers of black market websites to try the legal offer. For this reason, advertising expenses in France are estimated to be approx. € 340 m, with expenditures during the World Cup totaling some € 40 m⁸⁰. Since advertising expenses include sports sponsorships, conditions that allow higher spending in this area will ensure better funding of sports and support advertising channels (specialized press, ad hoc sites and forums), which are currently in need of financial resources since the traditional industries have downsized their advertising budgets.

Internet advertising for unlicensed gaming operators, however, is not restricted since it would be too difficult to control the Internet. This limit on advertising restriction is particularly relevant since online advertising is growing at a faster pace than the other channels and is more effective in reaching target online gaming customers.

Nevertheless, any removal of restrictions on mass media advertising would also have an impact on the Internet. Legal gaming operators tend to focus on high traffic websites (general portals, news, TLC, etc...) which are sensitive to the existence of a legal vs black market offer. On dedicated sites – such as gaming blogs, betting info services, etc. – legal operators share advertising space with unlicensed ones. What also needs to be taken into account is that legal and black market offer share the same space for advertising and viral initiatives on social networks and YouTube where advertising and marketing initiatives of legal and unlicensed operators are easily accessed. For this reason, any restriction on mass media advertising, although it represents an important initiative, does not suffice to compensate for the lack of an effective restriction on access to the black market websites, since the latter offer valuable opportunities and space for the promotion of gaming offers.

In sum, the removal of the advertising restrictions on mass media is a valuable tool for the legitimization of licensees. The effect, however, is limited to the mass media.

⁷⁹ See Decree n. 624, May 8th 2010

⁸⁰ Yacast 2011. Other sources (*Le marché des jeux d'argent en ligne; paris sportifs, paris hippiques, poker*, Eurostaf, Oct. 2010) reported 150m €.

5.2 How does removing advertising restrictions for licensees affect competition between legal and black market line-ups?

Looking at the regulation from an economic theory perspective, the elimination of restrictions on advertising in the mass media would be justified as an attempt to distort competition to the benefit of the legal against the black market line-up. By orienting gaming demand towards the legal offer, this distortion would be considered "positive". The degree of positive distortion depends on two main variables:

- i. profitability (as measured by operating margins);
- ii. attractiveness of the legal offer.

With regard to the first variable, regulation in the Italian market shows that marketing expenditure (without bonus) makes up around 30% of gaming revenues⁸¹. Mass media advertising is more expensive than advertising in other channels and needs a minimum level of investment to ensure visibility. Therefore, to allow legal gaming operators to become more visible than unlicensed operators, operating margins need to cover the fixed costs of advertising. Hence, in order to benefit legal operators, advertising restrictions would need to be eliminated in a business context with average operating margins that allow for high marketing investment.

As a consequence, low average margins - resulting, among other things, from the tax regimes - would reduce the positive distortion created by the removal of advertising restrictions. Low average margins could also justify the downsizing of marketing investments, further reducing the benefits of positive distortion favoring the legal to the black market offer. Moreover, downsizing marketing investments would affect not only expensive mass media advertising but also less popular sports sponsorships, confining sponsorship initiatives to top teams/top popular sports. It can be assumed that this will negatively affect the accomplishment of the objective to use gaming revenues for less popular sports funding; merely on account of their visibility, only the more popular sports events would be sponsored using the return on marketing investments (a typical case of "adverse selection").

As for the attractiveness of the legal offer, any positive distortion would also be subject to a secondary effect. In a first stage, the availability of mass media advertising facilitates the quick acquisition of new customers, both newcomers and existing customers, on the .com websites. The loyalty of the latter, however, depends on two factors.

Firstly, loyalty depends on the awareness for gaming safety and the reliability of gaming operators (most of them already well known in the .com world) created by advertising and communication. Awareness is strengthened by communication campaigns on legal gaming and responsible gaming developed by the State (as in the case of the Italian AAMS advertising campaigns with the dedicated "Gioco sicuro" logo which communicates legitimacy of legal gaming vs. black market offer).

Secondly, loyalty depends on the gaming experience. If, in terms of the range of the line-up and the payout levels, the gaming experience on legal websites cannot be compared to that of unlicensed websites, it is very likely that customers will keep "buying" the black market offer. Only an effective restriction on access to black market websites (currently not available) could achieve the result of reducing the black market size.

⁸¹ MAG estimation on industry data 2010

One could argue that newcomers are apt to remain loyal to the legal offer until they are used to it and discover a more appealing black market line-up. The promotion of both legal and black market line-ups on the Internet and dedicated websites is likely to accelerate the “familiarization” process by facilitating comparisons and osmosis between the two offers. Hence, the action of the two factors further reduce any positive distortion sought by the removal of advertising restriction.

In sum, the removal of advertising restrictions would be beneficial for the legal offer in principle; however, the size of the benefit depends on various variables that affect the legal offer's profitability and attractiveness. Any removal of advertising restrictions would not make a business with low profitability and a less appealing offer more competitive against the black market offer.

6 Concluding remarks: Towards a more balanced gaming tax regime

Legal and unlicensed online gaming offers coexist. They are not separate domains but different responses to an existing demand. For this reason, any approach that aims to prohibit unlicensed online line-ups is doomed to fail. A wiser approach would attempt to create attractive conditions for the legal offer to displace the black market. This would mean the use of tools and initiatives to increase the competitiveness and appeal of the legal offer vis-à-vis the black market offer. Reversing Gresham's law in economics⁸², conditions should be created that facilitate a "positive distortion" of the market and allow the "good" legal line-up to displace the "bad" black market offer.

The experience in France and Italy has shown that there are three levers to enforce a legal and responsible online gaming market which ensures customer protection and serves as a counterpoise to the black market offer:

- i) sustainable tax regime in business terms
- ii) an attractive gaming line-up
- iii) technology barriers to prevent unlicensed website access.

Evidence from regulated markets, like in Italy, reveals that only a balanced use of each lever will ensure that the black market is effectively outperformed. Carefully fine tuning all three levers can create conditions that will give the legal offer the resources it needs to successfully compete against the black market offer.

Tax regime

The tax regime in France has two sides to it. On the one hand, the same rake as the one used in the black market can be applied. Insofar, the success of poker depends not only on the high latent demand but also on the conditions that render the legal offer just as appealing as the unlicensed one but safer (due to the State control) and more intensely advertised.

On the other hand, tax rates on betting are higher than the average rates in the regulated market. As a consequence, gaming operators are compelled either to offer less attractive odds or to reduce advertising expenditure. The outcome is negative in both cases: if odds are not attractive, customers will move back to the black market offer after an initial stage of trying out the new line-ups. This would give bookmakers ample reason not to apply for licenses and sustain the size of the black market. Once licensees reduce their advertising expenditure, the distinctiveness of the legal as against the unlicensed offer disappears and the rate of new customer acquisition decreases accordingly (or becomes more expensive). In this case, too, customer migration from the unlicensed offer to the legal one would be slow (if any) and the size of the black market will continue to be substantial. Licensees who try to compete with the black market in terms of odds or advertising will soon find this unsustainable business-wise, since overall market growth would not offset the lower betting margins. The Italian case shows how an adequate tax regime - about 3% on turnover (MAG assessment based on official AAMS data) - allowed for market growth. As a result there is only a negligible difference between odds on .it websites and black market websites, and sustainability of licensed

⁸² "Bad money drives out good", Sir Thomas Gresham, 1519-1579

sportsbooks is guaranteed. In France and in Italy, business sustainability has an additional significance: resources for sports / cultural sponsorships, support for less popular sports federations and amateur sports federations in their effort to address the current economic crisis.

Gaming offer attractiveness

Gaming offer attractiveness is affected by a number of factors: i) restrictions on the regulated portfolio, ii) limitations to single products. In its handling of the regulated gaming portfolio, the French online gaming regulation, as defined by Law no. 476/2010, is largely incomplete. The regulated games represent only a portion of the online gaming portfolio, with casino games, bingo and (less importantly) lotteries and skill games outside the regulated domain. Altogether these are estimated to generate 2/3 of the overall turnover (.com and .fr). This limitation is intended to prevent any incentive to irresponsible gaming and is based on the assumption that there is a stronger correlation between ludopathy and games of chance than ludopathy and skill games. However, this same limit creates a gap between legal and unlicensed offer, making the latter more appealing. For lack of a reliable procedure to block access to black market websites, customers therefore still find the unlicensed offer available. Moreover, higher-profile online gaming companies opt for compliance in order to avoid any regulatory risk, whereas the unlicensed offer tends to be in the hands of less controlled, less transparent gaming operators located in tax heavens or difficult to reach. In other words, this gap does not help to curb the black market offer. Paradoxically, it reduces customer protection in the unregulated gaming segments.

With regard to the limitation to single products, the above-described dynamics apply to betting whose appeal is largely affected by the constraints imposed to ensure the fairness of sports events (betting program control by ARJEL) and to prevent high winnings which overly incentivize gaming (max payout definition). Although these rationales are acceptable, the consequences have been underrated. In particular, a less appealing betting offer is likely to keep most of the demand on the black market websites. New customers, attracted by the advertising of legal gaming offers, soon discover a more appealing black market offer, strengthening the black market offer further. Finally, some potential licensees may decide to remain within the grey unlicensed zone since betting remains less developed. As the Italian experience shows, it took three years to create an effective regulated betting offer. The process involved reducing taxes and increasing the number of events. Nevertheless, many medium-to-large bookmakers continue to move outside the Italian regulated market since they consider the regulated offer less developed (among the best-known brands without a license in Italy rank Bet365, Interwetten, Betsson, Stanleybet, Paddy Power, [to which Ladbrokes and William Hill can be added but they have left the market] etc.).

Technology barriers

The French regulation adopted a framework based on product constraints and high tax levels to control market growth and avoid incentives that could prompt less responsible gaming. This approach would be effective if customers would not leave the legal offer domain; as a result, this approach can only be sustained by introducing technology barriers.

However, technology barriers for the prevention of online gaming are theoretical and symbolic rather than functional. The means to prevent website access have not been effectively developed in France, i.e. through agreements with the Internet service

providers. However, once this has been done, like in Italy, it is very easy, even for basic Internet users, to bypass the restrictions. Financial transaction blocks, as adopted by UIGEA, can be bypassed by using e-wallets. At any rate, approving such a constraint would create trouble at EU level, since it would be deemed to violate EU law. Even the ban on accepting French customers on black market websites has been controversial, since it may work with licensees (although difficult to enforce simply because the legal gaming portfolio is comparable to the unlicensed one) but it cannot be enforced with unlicensed gaming operators. In this way, the Italian experience proves that the strict enforcement of a ban on .com accounts for domestic customers acts as an implicit incentive to stay within the black market domain at least until the legal product portfolio is broad enough.

In sum, available technology barriers are not completely reliable and, paradoxically, their ineffectiveness may even distort the market towards the black market offer. As a consequence, the French regulatory approach, which uses technology barriers to impose and promote an unappealing offer, appears to be risky. Market size data that is currently available has been interpreted in this sense⁸³. Even if there is a significant migration of poker players to .fr on account of the competitive conditions, the legal offer generates an estimated 43% of the overall online gaming turnover in France and 72% of the overall online turnover in the regulated segments (See section 1.3).

The size of the black market deserves careful consideration in order to determine what needs to be done to adjust the regulatory framework and win the race against the black market offer. Ways need to be found to combine the effect of the three above mentioned levers effectively so they reinforce each other. Any unbalanced use, with a focus on only one of the levers, will lead to market distortion, preventing customers from being channeled towards the legal offer or only channeling them to the legal offer in an inefficient manner. Since effective technology barriers are still under construction, a reflection process on how to lower tax regimes on betting and remove some product constraints while maintaining the high standards of customer protection should start soon and involve all the stakeholders.

⁸³ « *Sans changement majeur de la loi cette ouverture sera un fiasco* », Interview to Nicolas Beraud, IGA Magazine Jan. 2011

7 GLOSSARY

- **ARPU** Annual Revenue Per User
- **ARJEL**, Autorité de régulation des jeux en ligne. ARJEL is a regulatory authority for online gaming, responsible for providing information and control measures to protect gamers, prevent gaming addiction and combat fraud. It currently employs 50 professionals and intends to increase its staff to 80 by the end of the year.
- **Authorized operators** are operators who have signed an agreement with ARJEL.
- **Banning of website access** means to prevent gamers from obtaining access to unauthorized websites thanks to an agreement with Internet service providers.
- **Black market/unlicensed gaming/offer/market/websites** includes all kinds of gaming activities carried out within the scope of the French Law. Reference is to operators without a license from ARJEL who offer gaming products with money prizes ("black market"), irrespective of whether these operators have a license issued by another country authority or not.
- **Blocking financial transactions** means preventing financial flows between gamers and unauthorized websites based on an arrangement with banks.
- **Cap** is the maximum amount of money that can be levied as taxes, i.e. € 1.
- **Cash poker** is a poker version where players can enter and exit the game whenever they want while retaining their potential earnings.
- **Compulsive gaming** is an urge to game in spite of harmful negative consequences or a desire to stop.
- **Entertainment costs** are the costs a customer pays for playing online gaming. It is inversely proportional to the payout ratio.
- **Fixed-odds betting** is a form of wagering against the odds posted by a bookmaker.
- **Gaming accounts** are accounts opened on a website in order to place bets or play poker. These accounts can be temporary, if data has yet to be validated, or definitive. Winnings can only be withdrawn from a definitive account.
- **Gross Gaming Revenues (GGR)** is turnover less winnings paid out to customers.
- **Gross Gaming Turnover (GGT)** is the sum of all stakes placed by the gamers, including those originating from previous winnings or promotions offered by the operator.
- **Legal gaming/turnover/offer/websites** includes all operators with a French license issued by ARJEL or monopolists established under the specific regulatory framework.

- **Liquidity** is a key success factor in poker. It refers to the number of concomitant players in a poker room. The higher the liquidity the more likely for a player to start a play session quickly.
- **Maximum payout** is the maximum percentage on turnover, determined by decree, which operators are not allowed to exceed when distributing winnings. In the French case, decree no. 2010-605, issued on 4th June 2010, specifies that the payout, which includes not only winnings but also bonuses and other promotions, shall not exceed 85% of turnover, both in horse and in sports betting.
- **Payout** is the percentage of turnover due to gamers as winnings.
- **Pool** is a type of betting where all gamers' stakes are collected and the resulting jackpot is then shared among the winners.
- **Pot** is the total amount of stakes placed by players during each gaming session.
- **Product portfolio/Gaming portfolio** is the total number of games allowed.
- **Public authorization system** means that only operators with approval from ARJEL are allowed to commercialize gaming products on their websites.
- **Rake / Margin** is the difference between turnover and payout.
- **Result** is an event's outcome.
- **Revenues** are the margin of turnover remaining with an operator after winnings and taxes have been paid.
- **Sportsbooks** are operators offering sports bets at fixed odds.
- **Sports federations** are federations or associations that manage and organize sports events.
- **Sports rights** are fees paid by bookmakers to the organizers of sports events entitling the former to offer bets on these events.
- **Spending** is per-capita gaming expenditure, equal to turnover less payout.
- **State revenues** are revenues for the Treasury from taxation on turnover.
- **Supply chain** refers to all actors involved in the online gaming offer, namely the State, other public authorities that levy gaming taxes, operators and the gamers themselves.
- **Taxes** include all the money, calculated as a percentage on turnover, that is devolved to the Treasury or other public authorities.
- **Tournament poker** is a poker version where players pay an entry fee to participate in a competition. Tournaments end when one of the players wins the

stakes of all others. If a player leaves the competition before it ends, he/she forfeits the entry fee.

- **Turnover breakdown** is the scheme according to which turnover is shared among the different stakeholders in the gaming value chain, namely the gamers (winnings/payout), the State (taxes) and the operators (margin/revenues).
- **Unique active players** are customers who use their gaming accounts at least once a week.
- **Winnings** see Payout.