MEGA
MANX EGAMING ASSOCIATION

MeGA Sector Review 2016

Each year since its inception in 2006, MeGA (Manx eGaming Association) has conducted a survey of its members and others involved in the e-gaming sector in order to assess the development and needs of the sector on the Isle of Man. This, the 10th annual MeGA Report, has been conducted against a backdrop of increased regulatory requirements, a harsher tax environment, challenges to the privacy of beneficial owners and increased anti-money laundering scrutiny and compliance. Despite this, Government has reported that the e-business sector in the Isle of Man, including e-gaming, is going from strength to strength. The latest statistics available (Isle of Man National Income Accounts 2013/14, produced September 2015) show an increase in the growth of e-gaming of 30% in a year. They show the sector representing nearly 17% of the Island's economy (compared with 9% in 2009/10) replacing insurance as the largest economic sector on the Isle of Man.

Overall the outlook within the Island's e-gaming sector itself appears to be positive with many respondents reporting a busy and successful 2015. Revenues are increasing in spite of the global challenges facing the industry. Many participants reported higher than predicted growth in both profitability and staff numbers; most anticipate continued growth for their own businesses in 2016, whilst some anticipate a slight levelling off.

MeGA has seen some issues raised last year as potential challenges to the Island play out over 2015, such as the UK's place of consumption tax (POC), UK licensing and the abolition of the whitelist regime. These issues do appear to have had an effect on licence numbers. Prior to the introduction of the new regime in the UK, since 2009 the Island enjoyed a steady year on year increase in licence applications. However, as the new regime bedded in, matured licensees with predominantly UK based players faced the additional cost of compliance with UK regulation, which certainly had an impact on their business strategies. Only 5 new licences were issued in 2015 and 17 licences were lost, with the majority citing (to the GSC) financial pressure as the reason to return their licence.

Local operators confirmed that POC has indeed created additional costs for them. UK licensing has continued to be a challenge, requiring additional management time to ensure ongoing compliance. Nonetheless, these issues do not really appear to have had the impact on operators that was anticipated, even for organisations with UK facing activities, and Government's response in introducing double duty relief at the end of 2014 has gone some way to assist.

The removal of whitelisting status also appears to have had a detrimental impact on the number of applications for new licences received within the first 6-8 months of the year. However, a small recovery was experienced towards the end of the year when the number of applications for licences started to pick up. Currently there are 40 licences (February 2016), compared with 52 at the same time last year, with one additional licence that has approval but which is yet to be paid for. As at January 2016 there were 4 applications for licences currently being processed by the GSC.

Notwithstanding these issues, Gambling Duty receipts increased to £4.6 million, (a 10% year on year growth) which is indicative of the continued strength of the sector and supports the general feeling that the Island continues to be a credible e-gaming jurisdiction, particularly for non-European markets.

The 2015 MeGA Report noted that the sector employed some 900 people and that the average salary was over £50,000. In most instances staff numbers continued to increase during the year. The exact number of people working in the industry is difficult to determine owing to the wide range of jobs and cross-overs with other sectors. However, it is clear that the numbers employed in the sector have continued to grow, along with the consequent contribution to GDP, and it is estimated to currently employ around 1,000 people locally. Continued increases in staffing are anticipated in 2016.

As the sector has continued to grow, recruitment of appropriately skilled and experienced staff has become a real challenge. Whilst the shortage of suitably qualified ICT staff is a global issue and not one faced solely by the Isle of Man, it is essential that the Island manages to attract and retain suitable people. Government's newly implemented work permit exemptions for ICT roles may go some way to help in the recruitment of off-Island IT talent.

Government is considering several other measures to combat this problem including marketing initiatives to promote the Island as an environment with well-paid employment, a high standard of living and personal security. This initiative may involve participation in a number of job fairs in locations such as Tel Aviv, Bratislava and Sofia, in order to promote the Island as an attractive place to work. DED is also hoping to link up with overseas recruitment agencies in areas such as Spain and Greece, where it understands there may be an availability of ICT staff. Closer to home Ireland, with its trained workforce and similar weather, may also be targeted.

Some felt the Island could strengthen its marketing message by including positives such as a low crime place to live, good personal safety, low pollution, easy and quick commute to work, good work-life balance, good sporting environment, a competitive tax environment and good infrastructure.

In recruitment, there is a need to target jurisdictions where specific skills are located. Careful consideration of jurisdictions is required to understand specific skill demographics. Jurisdictions such as Israel, and Eastern European countries such as Slovakia and Bulgaria, are examples of potential sources of required skills (and from where people are prepared to relocate), rather than Spain, Portugal or Greece. Experience has shown that it is recruitment and retention of staff from countries where people are wanting to trade up to higher qualities of life that has predictably seen more success. An understanding of this and the nature of the key recruitment messages should be reflected in Government's marketing strategies. It was suggested Government should consider undertaking any marketing campaigns in the native language of each target country to ensure the target audience is reached, rather than solely in English.

The Island's new IT school, offering a 3-year degree course, may provide a significant number of IT personnel in future years. However, the e-gaming sector requires experienced ICT personnel who can hit the ground running. There was a general feeling of scepticism as to whether the IT school will provide sufficient staff for IT businesses on the island although most felt the school will be successful.

It was suggested that Government and the private sector need to work together to provide bursaries, apprenticeships or some form of student loan assistance for the Island's under-graduates studying appropriate degrees off-Island, to encourage them to return to the Island (not necessarily immediately as experience gained off Island is also valuable) to pursue a career in e-gaming or ICT, and to build a relevant skill base on the Island.

However, it is not simply a shortage of IT skills that is being encountered; skills in digital marketing, social media, CRM and affiliate management - with experience in the sector - are also particularly scarce resources on the Island and may be a constraint on development for some companies. One company advised that in response to a vacancy for digital marketing only three applications had been received and none of the candidates had been equipped with the skills and experience required for the job. As a result, the position was reluctantly being located in a London office. Other similar examples mean employers appear to have little option but to establish some functions in other jurisdictions. Whilst this is not ideal, as remote management of resource is more difficult, it is nonetheless a workable model. Unfortunately for the Isle of Man, this means a loss of jobs, or the loss of opportunities for jobs, and a direct negative impact to income tax, National Insurance and VAT receipts, as well as the loss of spending in the local economy.

It is clear that in the year since the last MeGA report Government has worked hard to iron out difficulties that were being experienced by some MeGA Members in obtaining appropriate work permits. DED in particular must be thanked for listening to and acting upon comments and suggestions from companies whose growth was being restricted by the lack of human resource. However, specific issues affecting some of the Island's largest e-gaming companies remain, including spousal visas and the transfer of existing staff to the Isle of Man, where exemptions in these circumstances would be most helpful.

The Isle of Man Government and regulatory authorities are highly regarded and thought to be commercial and approachable. There is considered to be a strong working relationship between them, to the benefit of the Island. In particular, the GSC team and the quality of the regulatory environment are huge assets in the Island's offering as an e-gaming jurisdiction, and their value should not be underestimated. Events in Malta during 2015 remind us how important and potentially fragile reputations can be in this industry. The GSC regularly works with its counterparts in Gibraltar, the UK, Alderney and Malta to compare working practices and intelligence, and is currently working with regulators from three other jurisdictions to formulate a common testing framework for the future. GSC Chief Executive, Steve Brennan, is to be the next chairperson of the Gambling Regulators of Europe Forum, which meets annually and is attended by the major European countries. In addition, the Island rules for the protection of player funds are also a huge asset to the Island and to date have meant that no player has lost funds because an Isle of Man based operator failed. This is not the case in other jurisdictions.

The GSC reported that its dominant focus last year was AML/CFT and it is anticipated this will continue for the foreseeable future. With MONEYVAL due to visit the Island in April and with the work arising from the National Risk Assessment, there has never been a greater concentration on ensuring the industry complies with the FATF's recommendations. The GSC's recently re-engineered AML/CFT supervisory regime is currently being implemented in a sector-wide initiative. It is the intention for GSC to acquire appropriate powers that will allow it to impose sanctions on persistent non-compliant licensees. The Island does not have a problem in this regard but the requirement for such powers to be available is an international expectation.

In addition, the GSC is looking at legislative changes:

- removing an ambiguity about whether a crypto-currency can be used to create a gambling account
- clarifying what the player fund protection requirements are regards winnings that happen to be sitting with a licensee's betting partner (at the moment, those funds can't be re-bet without creating a fund protection issue)
- expanding the range of services a full licensee can offer a sub-licensee
- broadening the range of test certificates that will be accepted from other jurisdictions
- expanding the range of voluntary controls that licensees can offer to players to help them control their gambling

These changes should result in more flexibility for operators.

The Island has historically been an attractive jurisdiction for start-up operations which have been of significant value to the sector and provided an income stream for CSPs. Although many start-ups in this sector fail to get as far as their first audit and may present a higher reputational risk to the Island, it is important to remember that some will go on to succeed. It is generally acknowledged that the Island's larger, leading CSPs have developed exceptional expertise in gaming services, including incubation services for new companies, and have a good reputation across the sector. They also do a first-class job of marketing the Island whilst promoting their own services.

Some respondents felt that as the UK's Diverted Profit Tax ("DPT") and the OECD's Base Erosion and Profit Shifting ("BEPS") activities increase, there will be more challenges facing CSPs and the managed entity approach. Having a substantial place of business on the Isle of Man is becoming critically important to ground an enterprise's claim to its Island tax jurisdiction. A company potentially will not be believed to be an Isle of Man tax-based company if it is only managed here by periodic board decisions. Others however, felt DPT will not apply to the vast majority of Isle of Man gaming companies and that it may indicate the Island would be better targeting smaller entities that fall outside the rules.

Attracting another large business to relocate all or some of its operations to the Island is attractive and Government should be trying to achieve this. It is acknowledged that such a strategy would be challenging as this type of business is scarce and keenly competed for amongst rivals. There is of course merit in attracting both start-ups and big business, however, the Island should be more discerning about the start-ups it engages with. Microgaming is a good example of the benefits for the Island of having such a large scale business, and it is extremely positive to see its continued commitment and investment in the Island.

It was felt by some respondents that the Island still has some work to do to support its existing businesses, to create an environment where they can continue to expand, to ensure their needs are being met wherever possible, and not give them reason to want to be anywhere else. It is far easier to leverage existing relationships than seek and successfully attract new businesses. By way of example, Government will surely have taken a proactive role in identifying the means to enable PaddyPower to remain on the Island following their recent merger, which may put it at risk of being removed from the Island by its new partner based in Gibraltar. It is essential, therefore, that Government not only engages with these organisations, but understands what they require. It is important to remember that these companies create a pool of talent and excellence within their organisations, as well as employing large numbers of local workers. Their departures would have ramifications for the Island as a whole, not just the e-gaming sector.

In addition to the mainstream e-gaming companies located on the Island there are also emerging niche groups. Approximately a dozen proprietary betting operations continue to do well on the Island. They are different in nature and in the skills required to other parts of the sector and are quietly getting on with their business.

Last year, some respondents felt Jersey's desire to compete in e-gaming was a very real threat given its VAT status and lower licence fee. With apparently differing views held between Jersey's authorities and establishment on the merits of having a gaming sector, even Jersey itself appears to believe it has missed the boat. To date, Jersey has issued two temporary gaming licences. Jersey should not be a threat because the markets they potentially serve are different to those where the Island has a realistic chance of competing. The Isle of Man should not be complacent however and must remain alert to the potential threat from Jersey or a combined Channel Island offering.

The range of both attractions and problems of each of the jurisdictions highlights the importance for the Island to focus its marketing message to ensure it is able to compete for and attract appropriate new business.

- Guernsey continues to have power issues
- Alderney has been very quiet, suffering from a massive loss of continuity due to a series of departures of key personnel
- Malta has 208 unique licences and has invested heavily in its infrastructure by improving resilience, although there are still issues. It is a low cost jurisdiction in which to operate and so particularly attractive to start-ups. However, a recent money laundering scandal led to some licences being revoked and damage to Malta's regulatory reputation
- Gibraltar, which has good quality licensees and at least 2,000 employees in the industry, has power issues, limited space, and is an expensive jurisdiction in which to set up a licence and do business. It may be impacted by mergers and acquisitions, such as Ladbrokes and Gala Coral.

The Isle of Man must not be embarrassed to compare itself favourably with other jurisdictions or to talk of financial and other advantages. Advantages for the Island include personal security, no corporation tax, highly regarded regulatory regime, commercially minded regulator and a respected licence regime, great hosting and infrastructure, a responsive and accessible government, and a network of first class companies. The Isle of Man is a first class jurisdiction. The quality of data centres on the Island is world class with significant funding having been invested in them; the service they provide is second to none. They are supported by an efficient and reliable power source and good telecommunications infrastructure; costs are comparable to competitor offshore jurisdictions.

A message repeated many times was that Government needs to be clear in its marketing strategy and message and that it would be helpful if Government articulated its strategy for the sector. It should identify jurisdictions and business models to be targeted, how this would be achieved, what products should be available on the Island and establish clear marketing messages conveying the advantages of being located on the Island.

Government and the sector must also be mindful of how the Island is promoted locally as well as internationally. Gaming is after all an industry for adults. Although highly regulated, the gaming industry disengages as many as it engages; for many it sits in the same category as other adult entertainment. Government's key principle is to protect the vulnerable and keep out criminality which MeGA wholeheartedly supports.

In terms of Europe, it is generally believed that it will be some time before there is uniform licensing and as such, onshore solutions are required, becoming more complex with country by country licensing. For operators and their advisers utilising multi-jurisdictional licensing as solutions for their clients, the Isle of Man licence is a likely component of such a strategy. Changing complexities in jurisdictional licensing and offerings have encouraged one CSP to launch a consultancy business in e-gaming, headquartered on the Isle of Man. It will provide solutions to clients using jurisdictions that provide the best outcomes to suit the needs of the client, an approach successfully used by TSPs and CSPs for many years. In this way a strong relationship can be built with the client which makes it far more likely to enable the Island to secure part (or all) of the operation if not now, then in the future.

Flight connections to the Island remain a concern – but thanks to Microgaming, BA CityFlyer was encouraged to establish a more frequent Ronaldsway to London City air link during the winter of 2013/14 and BA has continued to operate a reliable and frequent service to the City since. During the year Flybe's new Stansted route threatened the economic survival of BA CityFlyer's London City route, however, as predicted and in line with previous similar situations, the Flybe service was not sustainable. Flybe has now ceased to operate the Stansted route. It is generally agreed that experience has shown that the Island ideally needs two carriers – one for the leisure market and one for business users. It is critically important to ensure reliable and sustainable air links with London. To maintain this position "open skies" may not be the most sensible strategy.

Whilst grateful for the London City route, Members reported that City is not always an ideal London airport especially for international connections to Heathrow. The arrival of Crossrail in late 2018 may help to alleviate this. Also, the lack of flights to London at weekends continues to cause a problem especially for the Island's business community returning to the Island after a working week overseas.

The topic of Bitcoin was very much on the agenda last year and many were still undecided as to its potential. However, this year all were agreed that it has not established the stability, durability or robustness needed for it to be a credible threat to banking. Bitcoin itself, however, is only an application and it is the block chain technology behind the application, tracking and recording transactions, that is now recognised by the largest credible organisations to have the greatest value. Money is already being invested to identify how blockchain will save organisations money and make them more efficient. Given the Island's world class data centres, resilient power supply and proven ability to handle "big data", this may present an opportunity for the Island. DED are currently looking at secure data stores here with ability to access, distribute and update data with a full chain of history of actions. In addition, the GSC has a strong initiative under way to clarify the Bitcoin situation. This may enable some existing operators to quickly adopt parts of the protocol and make the Island instantly attractive to a handful of new operators. However, respondents report that whilst gaming companies appear to be keeping Bitcoin on the agenda should it become viable, there is little expectation that this will happen in the near future.

A number of respondents attended ICE Totally Gaming in early February. It is generally agreed that it is important for the Isle of Man to have a strong presence at the event and that Government's stand is well organised with a co-ordinated approach. However, respondents felt it is essential to ensure that there is a balanced combination of attractive presentation supported by an available depth of knowledge on the stand at all times. Although most attended the event without any expectation of acquiring new business, some reported great success in that regard. Respondents felt it was essential to be present at ICE. The event, which is of an extremely high quality, provides an excellent opportunity to meet existing clients and contacts, and network at functions held within the conference. Although ICE was not as busy as previous years, the quality of attendees was considered to be extremely high with clients, professionals, financiers and potential customers all present.

A number of potential opportunities for the Isle of Man are currently being reviewed by Government including daily fantasy sports and e-sports. There was mixed enthusiasm for these markets from survey participants. Some felt the adverse reaction to these activities in the USA was indicative of the hurdles to be overcome and that the Isle of Man was not a natural home to this group. Others felt there is a genuine opportunity. It was generally agreed that it is pleasing to see Government investing time in looking beyond the traditional e-gaming activities for new business opportunities. In addition, Pokerstars' recent move into the sports betting industry with its new sportsbook released last year, and Lottery, may also provide further opportunities.

In summary, sector 'chatter' is relatively subdued this year with an air of waiting to see what, if any, changes will take place as a result of recent Government appointments. The general feeling is 'business as usual'. DED is generally considered to be doing a reasonable job, although it was noted Government should listen to the opinions and advice from those in the sector and more regular communication with key players would be helpful. It was emphasised that consultation is more than simply listening to views. It involves responding effectively with clear indications as to whether Government agrees or disagrees and is willing to implement any recommendations. One message repeated many times was that Government needs to be clear in its marketing strategy and message and that it would be helpful if Government articulated its strategy for the sector. It should identify jurisdictions and business models to be targeted, how this would be achieved, what products should be available on the Island and establish clear marketing messages conveying the advantages of being located on the Island.

Although, unusually, there were no stand out issues, each of the companies continued to face specific and important challenges to the success and development of their own business as well as having concerns regarding factors that affect Island businesses generally such as the state of the Island's financial affairs, potential upcoming political changes and guaranteed London flights as well as on 'soft issues' such as the quality of health care provision.

The companies interviewed were confident they would continue to see growth within their own organisation in the coming year although the Island's e-gaming sector is more likely to remain fairly static and unlikely to continue to grow as it has in the past.

Most feel the Island is still considered to be an attractive jurisdiction for e-gaming businesses, particularly for the unregulated markets but that the Island must consolidate, strengthen and share its marketing message. Whilst Government should lead the way in delivering the message, the private sector is willing to assist in spreading the word about the Isle of Man as a good location to live and work. However, Government should not underestimate the importance of soft issues:

- any perceived issues surrounding the provision of healthcare, education or transport links for example must be addressed rather than ignored
- the Islands education system and health care provision must be compared to the best internationally rather than the UK
- Government must rectify issues where they are found and where there is evidence to discredit negative messages Government should produce this and silence the naysayers.

The Island is a great place to live and work and this message must be clearly communicated on and off the Island if it is to attract quality staff or organisations.

The local sector is dominated by several e-gaming giants and they have helped to build the good reputation the Island enjoys today. The downside of such a dynamic is that the sector is subject to concentration risk. The Island must nurture and support its existing businesses whilst at the same time attracting new businesses, especially those who already have a market presence, who can set up a significant presence on the Island and contribute positively to the local economy. New start-ups should continue to be welcomed but with the understanding that unless they are appropriately funded their long term viability is questionable.

Increasing costs of compliance, taxes and operational costs all make growing an organisation organically quite testing. Scale is important, as demonstrated by the recent mergers and acquisitions, as larger organisations are better equipped to deal with rising costs and the increasing burden of regulatory and AML compliance. Mergers tend to lead to rationalisation and being alert to such events is important. Although it is anticipated that the percentage of GDP from gaming is likely to increase, this is likely to be as a result of existing operators increasing their turnover and possibly from declines in other sectors.