



Joint Working Group:
Outsourcing in remote
gaming

1. Introduction

As the remote gaming industry continues to develop, grow and ventures into new markets it is increasingly relying on outsourcing. Notwithstanding the fact that the Malta Gaming Authority (MGA) has long accepted this practice and intends to continue upholding it, it deems a policy on the subject matter is necessary. For this reason, the MGA wishes to work on the formulation of a draft policy in conjunction with the gaming industry and for which a Joint Working Group is being set up with members representing the widest possible spectrum of the industry, together with the MGA.

The aim of this paper is to generally introduce the concept as well as the perspective of the MGA on outsourcing in remote gaming. It seeks to set out a number of parameters for a Policy on Outsourcing that the MGA would like to develop and adopt in collaboration with the industry. This paper is not meant to be exhaustive but rather is being presented as a mere starting point for discussion and further development by the Joint Working Group.

Objective of the Joint Working Group: To propose a Policy on Outsourcing based on a defined set of principles that can be implemented through soft or hard legislation in the near future.

Composition of the Joint Working Group, Members and participation: The Joint Working Group shall be composed of 10 members: four (4) from the MGA and six (6) Members representing the remote gaming industry. The Group shall elect its Chairperson from amongst its members. Members of the working group may invite senior industry officials or their representative bodies, or other regulator/s, with knowledge/experience in the sector and subject matter being discussed, including stakeholders' representatives of service providers of outsourced activities; for example, the Malta Financial Services Authority (MFSA), banks/financial/payment services providers, managed service providers, and so on. The Working Group may receive such representation and input from other stakeholders in person (through participation/presentation in meetings) or in writing,

Timeline: The Joint Working Group will be launched once the nominations are made by the industry (during September 2015) and will remain operational for a period of 12 weeks, by which time it is expected that the Working Group would have adopted a common position on a proposal for a Policy on Outsourcing, with input from other relevant stakeholders. In the event of unavoidable and reasonable constraints, the timeline may be extended by the MGA.

Meetings and Participation: Meetings shall be held physically or using secure tele-conference facilities.

2. Policy on Outsourcing in Remote Gaming: Concept and rationale

Today outsourcing is increasingly used, by many sectors, notably the remote gaming sector, as a means of both reducing costs and of achieving strategic aims. Remote gaming businesses throughout the world are increasingly using third parties to carry out activities that the operators/licensees would have traditionally undertaken themselves. Regulatory information at hand shows that licensees are outsourcing significant parts of their regulated and unregulated activities across their whole operational and supply chain to reach their final consumer – whether remotely or otherwise. It often provides market specific services that may take too long to build in-house. At times, even some of the core functions are outsourced, such as that of the key official or other senior management with effective control of the operations of the licensee. As the industry evolves, new markets open, regulatory and fiscal burdens increase and cost reduction is increasingly becoming critical to survival and growth. This may be just one of the contributing factors to the wide use of intra-group and third party outsourcing by the sector. Increasingly more complex arrangements are developing whereby related entities perform some activities, while unrelated service providers perform others. In each case the service provider may or may not be a regulated entity (for example, payment gateways).

The complexity of the outsourcing arrangements, the nature of services being outsourced and the jurisdiction of the service providers are just some factors that may be of concern from a regulatory perspective which may warrant some form of regulatory oversight and/ or intervention due to the potential or actual transfer of risk, management and compliance to third parties who may not be regulated by the MGA or other regulators (sectoral or otherwise), and who may operate in other jurisdictions and/or have an offshore operation.

The principles and policy on outsourcing that the MGA would like to adopt should be designed to apply whether the service provider is a regulated entity or not – with reference and reason as to whether, beyond mere visibility and relevant information; these services and their providers ought to be monitored and regulated (such as by means of approval or certification) by the MGA.

In the current and evolving situations, how can the licensees remain confident that they remain in charge of their own business (whole business processes to final consumer) and in control of their risks, notably their regulatory and compliance risks? How do they know that they are complying with their regulatory responsibilities? How can these licensees demonstrate that they are doing so when MGA/regulators seek to audit and verify the operators' regulatory standing and performance?

The Working Group is being asked and tasked to develop a set of high-level principles and policy proposal about outsourcing to help answer these questions and to guide the MGA.

The policy proposal needs to establish the key issues and risks in sufficient detail and set out the principles that can serve as benchmarks. The principles would need to offer specific and focused guidance and be applicable across the remote gaming industry (irrespective of product or licence classification) as it stands today and as it is envisaged to evolve in the coming years. It is foreseen that the proposed policy will also identify what could be

considered as 'critical' in both functions/activities *per se* and interfaces between in-house functions and outsourced functions/activities/services.

3. Definition of outsourcing

'Outsourcing' is usually defined as a regulated entity's use of a third party (either an affiliated entity within a corporate group or an entity that is external to the corporate group) to perform activities/functions on a continuing basis that would normally be undertaken by the regulated entity, now or in the future.

The EU defines outsourcing within the context of MIFID1 as *"an arrangement of any form between an authorised entity and a service provider by which that service provider performs a process, a service or an activity which would otherwise be undertaken by the investment firm itself."*

The Joint Working Group is requested to propose an applicable definition of outsourcing for gaming that takes into account the regulatory, cross-jurisdictional and operational relationships and risks faced by a gaming licensee. With this in mind, the Working Group should take a broad approach as to what is defined as outsourcing, not taking into account how relationships are currently classed and asking how they appear objectively.

Activities and functions within a licensed legal entity can be performed and delivered in diverse ways. A licensee may split functions, such as management and control, product development, marketing, back-office and distribution, within the same regulated entity falling within the same sphere of control that is approved by the MGA. Where a licensee keeps such arrangements in-house, but operates some activities from various locations in the European Economic Area (EEA), this may be considered as not falling under the foreseen ultimate definition of outsourcing. The MGA considers that, in such instances, the applicant, and/ or licensee, would therefore be expected to provide the MGA with information about the locations in which these functions are being undertaken and make a provision for any risks posed by this arrangement within a general risk management framework.

¹ DIRECTIVE 2014/65/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU. Link: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0065&from=EN>

4. Current regulatory practices and policies on outsourcing

Although some gaming jurisdictions have mentioned and approached the subject, there does not seem to be a defined, explicit and detailed policy on outsourcing in remote gaming as yet. This notwithstanding that there is an evident uniform approach, amongst jurisdictions, that the compliance responsibility continues to reside with the licensee, irrespective of the outsourcing arrangements that may be in place at licensing stage or thereafter.

For example, the gaming regulatory framework to be adopted by The Netherlands² foresees that outsourcing per se would not be considered problematic by the competent authority, provided that compliance with regulations on games of chance and the monitoring thereof continue to be guaranteed. Outsourcing does not therefore release the licence-holder from its obligations. This would also include cases of limited parts of the operational management such as advertising and canvassing. It is foreseen that The Netherlands will adopt subsidiary legislation that will set further requirements on outsourcing of parts of the operational management.

The Jersey Gambling Commission requests to know what functions are outsourced, to whom and why³, which is largely similar to what the MGA has currently in place (with the exception of the 'why?').

Other than in the financial services sector, there is no specific regulator provision that addresses outsourcing. However, depending on the sector and services involved, parts of the outsourcing transaction may be regulated by various elements of national law, such as data protection and IP rights.

Article 16(5) of Directive 2014/65/EU (MiFID II) states that:

5. An investment firm shall ensure, when relying on a third party for the performance of operational functions which are critical for the provision of continuous and satisfactory service to clients and the performance of investment activities on a continuous and satisfactory basis, that it takes reasonable steps to avoid undue additional operational risk. Outsourcing of important operational functions may not be undertaken in such a way as to impair materially the quality of its internal control and the ability of the supervisor to monitor the firm's compliance with all obligations.

An investment firm shall have sound administrative and accounting procedures, internal control mechanisms, effective procedures for risk assessment, and effective control and safeguard arrangements for information processing systems.

This corresponds with Article 13 (5) of Directive 2004/39/EC (MiFID I).

The MFSA has adopted various guidance on the implementation of outsourcing in the Financial Services Sector such as BR 14/2009⁴ on 'Outsourcing by Credit institutions

² Ministry for Security and Justice (2013/4b) Article 31i, pp. 63-4

³ <http://www.jerseygamblingcommission.com/assets/uploads/Remote%20Gambling/Remote-Gambling-Operators-Post-Licensing-Regulatory-Framework.pdf> : see page 2

⁴ <http://www.mfsa.com.mt/pages/viewcontent.aspx?id=533>

authorised under the Banking Act 1994'. Other guidance and information notes were issued more recently further to System of Governance requirements under the Solvency II regime. The rules and practices applied in the financial services sector regulation are considered by the MGA to be appropriate reference for the Working Group in setting up the general principles and a proposal for an Outsourcing Policy for remote gaming which can be further developed to take account of the specificities of the gaming sector.

5. Some guiding principles

The MGA identifies outsourcing as an attribute of the remote gaming industry that raises issues related to risk transfer and management, frequently on a cross-border basis. The MGA considers that this increased reliance on the outsourcing of activities may impact on the ability of licensees to manage their risks and monitor their compliance with gaming regulatory requirements and other general requirements (such as AML and data protection). Additionally, there is increased concern on how outsourcing could potentially impede the ability of licensees to demonstrate to the MGA (for example, through regular monitoring processes, audits and investigations) that they are taking appropriate steps to manage their risks and comply with applicable regulation at the pre- and post-licensing stages.

Among the specific concerns raised by outsourcing activities is the potential for over-reliance on outsourced activities that are critical to the ongoing viability of a licensee as well as its obligations to MGA and its players. This includes data protection and data security.

The MGA and the sector in general can mitigate these risks by taking steps to, for example, draw up comprehensive and clear outsourcing policies; establish effective risk management tools at both pre- and post-licensing phases; require contingency planning; establish template outsourcing contracts; establish thresholds or limits in functions that can be outsourced (without limiting innovation, time to market and or development); and regulate unregulated service providers (for example through certification/approval and minimum requirements that must be adhered to in order to service a MGA licensee).

Of particular interest to the MGA is the preservation of strong corporate governance in the sector. In this regard, outsourcing activities that may impede an outsourcing operator's management from fulfilling its regulatory responsibilities are of concern to the MGA. The rate of distribution/marketing, product innovation and convergence between markets and products, together with time critical launches and an increasing reliance on external service providers, have the potential of leading to systemic problems unless they are appropriately constrained by a combination of market and regulatory influences – and possibly even intervention.

The MGA is often concerned and would like to address and mitigate risks that may follow from concentration of dependence on third-party providers when considering systemic risk issues.

Despite the issues raised by this paper and others that may arise in the course of discussions and formulation of policy, the MGA is committed to ensure that any regulatory intervention, including those emanating from enhanced monitoring and reporting processes,

is kept to the bare minimum, which may be adjusted, on a case-by-case basis, depending on the risk profile of the individual operator and operation.

The nine (9) high level basic principles that follow have been adapted, for guidance, from the Basel Committee on Banking Supervision on Outsourcing in Financial Services⁵.

- I. An applicant/licensee seeking to outsource activities and/or functions should have a comprehensive policy in place to guide the assessment of whether and how those activities, and/or functions, can be appropriately outsourced. The board of directors or equivalent responsible body retains responsibility for the outsourcing policy and related overall responsibility for activities undertaken under that policy.
- II. The applicant/licensee should establish a comprehensive outsourcing risk management programme to address the outsourced activities and the relationship with the service provider.
- III. The applicant/licensee should ensure that outsourcing arrangements neither diminish its ability to fulfil its obligations to customers and regulators, nor impede effective and timely supervision by the MGA.
- IV. The applicant/licensee should conduct appropriate due diligence in selecting third-party service providers.
- V. Outsourcing relationships should be governed by written contracts that clearly describe all material aspects of the outsourcing arrangement, including the rights, responsibilities and expectations of all parties, including regulatory access where applicable.
- VI. The licensee and its service providers should establish and maintain contingency plans, including a plan for disaster recovery and periodic testing of backup facilities.
- VII. The licensee should take appropriate steps to require that service providers protect confidential information of both the licensee and its clients from intentional or inadvertent disclosure to unauthorised persons.
- VIII. The MGA should/would take into account outsourcing activities as an integral part of its pre-licensing checks of an applicant and ongoing monitoring and supervision of the regulated entity.
- IX. The MGA should assure itself by appropriate means that any outsourcing arrangements do not hamper the ability of a licensee to meet its regulatory requirements and obligations. In addition, the MGA should be aware of the potential risks posed where the outsourced activities of multiple regulated entities are concentrated within a limited number of service providers.

⁵ <http://www.bis.org/publ/joint12.pdf>