



## SANTA CASA

Misericórdia de Lisboa. Por boas causas.

### Fernando Paes Afonso

Vice-President,  
Santa Casa da  
Misericórdia de Lisboa  
Chief Executive Officer,  
Games Department

**Paul Jason, Public Gaming:** *You have a passion for the mission of defending the rights of member states to determine the regulatory and taxation framework that serves them best. Does this conflict with the principles that established the Common Market of the European Economic Community?*

**Fernando Paes Afonso:** Not at all. According to the Treaty of Rome that established the first foundation for the European Economic Community in 1958, requirements to open the markets to competition and cross-border trade do not apply to gambling and lottery. This point of law has been re-affirmed by the European Court of Justice in numerous rulings since then. The reasons for this are obvious and were recognized then and apply today more than ever.

There are rules that apply across the entire community of European Union nations as regards to almost all forms of trade and commerce. These rules form the basis for the Common Market intended to stimulate economic growth by fostering free trade and open competition. All EU member states are required to allow free-market competition and unencumbered cross-border commerce. However, gambling and lottery are excluded from this requirement and classified as being something other than “normal” economic activities that fall under those guidelines for

**PGRI Introduction:** Mr. Paes Afonso brings the perspective of a private-sector economist to his leadership role in the lottery industry. He served as president of the Portuguese lottery between 2002 and 2005, was re-appointed to that position in 2011, and was just appointed to the Executive Committee of the European Lottery Association.

The 2009 European Court decision supporting Portugal's right to regulate its market, and blacklist illegal operators like Bwin, was a landmark win for EU member states against illegal internet gambling operators; and a victory for charitable causes which depend on funding from state lotteries. Our discussion at the World Lottery Summit in Montreal explores the current gaming environment in Europe and the reasons why lottery operators need to work together to help government defend its right to regulate and tax the gambling markets.

free trade and open markets. The reason for this exception, of course, is that gambling and lottery have potential social costs, there is a potential for fraud and illegality, and each jurisdiction is a different market-place with different gambling cultures and different public policy objectives. For these reasons and more, the European Parliament has recently re-affirmed its conviction that the matter of taxing and regulating the gambling and lottery industries should be left completely up to the individual member state. The European Union Commission is charged with creating a common market in Europe but is also bound to consider the will both of the Parliament and of the Council because there are the member states who make up the Union. It doesn't mean this industry should not be subject to rules and regulations that relate to the interests of the European Economic Community, just that member states should not all be forced to regulate and tax gambling as though it were simply another commodity.

*But what if the European Union Commission disagrees and attempts to impose a pan-European regulatory structure?*

**F. Paes Afonso:** The over-arching rule of law in the European Union has an interesting similarity to the U.S. law. Gambling is illegal until and unless legislation is passed at the member state jurisdictional level making it legal. Given that fact, how can you have a pan-European regulatory structure when each member states has the right to determine whether it even wants to allow the games to be offered? That is why the entire issue of regulations and taxes needs to be determined at the member state level. That is why the European Parliament in 2005 clearly stated its conviction that because of different social contexts, different moral standards, different national approaches to the concept of public order, and different gambling cultures, it is accepted that the legal and regulatory framework will vary from country to country, and that gambling and lottery should be excluded from the scope of the free movement of goods and services in the common markets. The European Court of Justice has been re-affirming this position ever since it was first brought up.

*A big issue here at the World Lottery Summit is enforcement of the laws against illegal operators, especially as it relates to sports-betting.*

**F. Paes Afonso:** The issue is actually much bigger than sports-betting. The internet has completely reshaped the regulatory environment. Governments and regulatory

frameworks need to adapt. New enforcement mechanisms are needed to compel operators to comply with the laws. They need to address this problem immediately because it affects all forms of gaming. And as new forms of social gaming are introduced into the market, the problem of enforcement will explode. This affects everyone everywhere.

Lotteries typically operate within a monopoly model. Even so, we must acknowledge that we live in a market-driven world, which means that the market will find ways to satisfy consumer demand. It does not mean, however, that the market-place should be controlled by operators who do not act in the best interests of society. Gambling is not a brand new economic activity. It has been around for a very, very long time. But governments have always exercised authority over the gambling markets in order to preserve Public Order and diminish the social costs of gambling. Government cannot abdicate this responsibility just because the internet now gives merchants and gambling operators easy and instant access to all consumers. In fact, the exact opposite is true. The need for government to control this industry is more pressing than ever precisely because the internet makes gambling so accessible to consumers.

Internet gambling, including online sports-betting, poses more serious challenges to Public Order than land-based gaming for a number of reasons. The first is obvious, and that is because it makes gambling available in the home of the consumer which increases the amount of time that the consumer can easily gamble. The second is not so obvious but just as important. Games are social. Going to a store to buy lottery tickets is actually a social activity. When people gamble at home, they are taken out of that social context. Removing that social element changes the essential nature of the activity from something that promotes social cohesion to an impersonal transaction that does nothing to promote what we might call "social capital", which is the concept that social interaction is actually a positive force for the health of the individual and by extension the economic well-being of a healthy society. Activities that promote social interaction contribute to social cohesion and that is the basis of "social capital". Internet gaming reshapes the fabric of this activity so that it is less a game that promotes social cohesion and more about an impersonal transaction. It needs to be regulated with that concept in mind. Now, let's bring this conversation back to more practical matters of what we should do about it.

Internet gambling is a fact of life. The consumer demands it and that demand will be met. However, as a society, we can choose to manage it to minimize social costs and also endeavor to deliver optimum value to the consumer. What we do not want to do, and should not be compelled to do, is to allow i-gaming to be managed for the purpose of maximizing profits to commercial operators. That is diametrically opposite of the public interest. Internet gaming can be a positive force for society if managed with the goal of maximizing social capital, or at the least managing it for the purpose of minimizing social costs. The main point is that it needs to be operated with the explicit objective of promoting a healthy society. The ideas we have just been talking about are quite foreign to commercial operators. That is the reason why casinos have always been strictly regulated. The internet poses more serious challenges than casinos and so should be even more strictly regulated. That does not mean prohibited. It just means that the internet operator should be controlled by the government and its operation should be for a public service mission and not for private profit. That is why the government itself, or an agent that is under strict control of the government, should be the operator of internet gambling.

There are some that contend that uncontrolled access to internet gambling does not result in an increase of problem gambling. Common-sense says that is not true, studies confirm that it does encourage excessive gambling, and the European Court of Justice' decision to protect the state monopoly over sports-betting in the Santa Casa case includes wording from the judges themselves that recognize the validity of those studies. The prevalence of playing excessively through the internet is higher than in the retail network. And that's written right into the decision that the European Court of Justice rendered in favor of Santa Casa over Bwin and others. That is why the games should be made available over the internet only by an operator dedicated to protecting the consumer and serving the public interest.

*Are you making progress in the effort to forge an international cooperation to enforce the laws? Or at least a cooperation between EU member states?*

**F. Paes Afonso:** The issue of enforcement is not a European issue. It's a global issue. As we know by reading the news, many of the problems with illegal sports-betting originate with operators based in Asia. And all of these

same issues will emerge in all areas of internet gaming, including poker and new forms of social gaming. Interpol operates globally, but they need the support and cooperation from local jurisdictional governments. Consumers all across the world are now connecting to each other and to gaming operators through the Internet, mobile phones, tablets, and new consumer devices that are being invented every day. The monetary volume of online transactions is increasing exponentially.

Think about how consumer behavior has evolved over the last fifteen years. It was not long ago that the consumer personally knew the merchant where they shopped. Then they bought through mail-order catalogs and over the telephone. Then, when the consumer started buying online, there was a trust factor that had to be overcome. Now, consumers typically have no idea where the online merchant is based, and they don't really care, do they?! The free-market system no longer has any "invisible hand" to ensure consumer protection. That's why we need a completely new infrastructure to police the markets and prevent illegality.

*When you think of it that way, that is actually quite a dramatic shift in consumer behavior.*

**F. Paes Afonso:** Yes, it is. Anyone can locate anywhere and be an online merchant. There used to be market-driven barriers to entry into the business of consumer marketing. Those barriers do not exist anymore. So now we need a better system for regulating and policing the global market-place. And that is more true in internet gambling than anywhere for the simple reasons that the amount of money involved is so huge and the potential for fraud so great. We can see it happening now in sports-betting. But those lottery operators who do not offer sports-betting should realize that the same issues will affect all internet game categories, especially any kind of social games but also including the distribution of i-lottery products. Policing the internet gaming space will require a global cooperation. First, we need Interpol and other agents of international law enforcement need to recognize the importance of this challenge. That is not easy. In our industry, we see how much money is involved and how important it is to fight illegal operators. But Interpol and others who are dealing with terrorism and the highest-profile forms of illegality don't necessarily see the need to allocate resources to combat illegal sports-betting or i-poker. Second, we need

to engage the support of governments to allow Interpol and others to enforce the laws. Sports-betting is just the tip of the iceberg.

*Sports-betting constitutes less than 1% of your revenue. So, how much does it matter if other operators were licensed to offer sports-betting?*

**F. Paes Afonso:** Our charter is not about raising money, it's about protecting the consumer. It is not our goal to entice people to bet on sports. We make it available for those who want to bet on sports, but we do not market it with the objective of increasing revenues. Unfortunately, there is an illegal sports-betting market. Our goal is to protect the consumer from these illegal operators and channel the activity over to the legal offer. Our low revenues do not indicate that the market doesn't matter. It indicates that the illegal market has taken over in sports-betting and we need to address that.

*Do you feel that the agendas of the Games Department, the Lottery, and the government of Portugal are aligned? Do you feel like the legislators of the government of Portugal are responsive to the concerns that we've been talking about today?*

**F. Paes Afonso:** Indeed, the answer is positive. Of course we have to respect that the government is responsible for so much more than just the lottery or just gambling, and that it consists of public servants with a wide diversity of opinions. I can say that the government is taking a very thoughtful approach to these matters and that we appreciate the serious consideration they are giving to the goal of preserving Public Order and the integrity of the games. Portugal's government is currently gathering information and studying the data and working hard to achieve the best solution. The goal of the Game Department and the Lottery is to manage the business to support the public policy objectives of the government. That includes innovating the games to appeal to the consumer, managing the business to minimize problem gambling, and generate funds for the beneficiaries of the Lottery. But the government, the Gaming Department, and the Lottery are all keenly aware of all that is at stake and the importance of evolving our approach to the industry to achieve the best results for society.

*Sustainability is integral to your strategic approach.*

**F. Paes Afonso:** That is another reason why it is so important for government to keep control over the industry. Capitalist

markets are driven to maximize profits. But a by-product of that is to maximize sales. The key to maximizing sales in a capitalist market is to continually enhance the value to the consumer. The expedient way to increase value to the consumer in our industry is to increase the prize payout. While it is expedient, it is also misguided and detrimental to society and not consistent with sustainable and prudent public policy objectives. We do want to enhance value to the consumer, but we want to do it by increasing the entertainment value of the games, not appealing solely to the desire to win money. That is the best, if not the only, way to build sustainability into the business.

Increasing the incentive to gamble by increasing prize payouts does three things that are not in the interest of society. First, it decreases the funding to charitable causes. Second, it encourages excessive gambling. And third, it follows the path of all consumer products marketing and that is to create consumer expectations for better and better value. That creates a syndrome of increasing prize payouts, more problem gambling, and less funding for charitable causes. So, yes, we are struggling to preserve a sustainable approach to managing the growth of this industry. We realize that consumer demand for gambling will continue to increase and that the prize payouts will also continue to increase. But we can still manage the business for the purpose of meeting consumer demand and not stimulating it and accelerating the process.

In the end, the sustainable model is also the strategy that optimizes long-term profitability.

*You want to make the products available where the consumer is, and there are at least some consumers who are in fact on the internet.*

**F. Paes Afonso:** That is true and that is why we make our products available over the internet and mobile. But that is a tiny percentage of our revenues. Our focus is on retail because that is where the Portuguese consumer is. And as we discussed, it is also where we want to be for sustainable approach to growing the industry. In fact, for all the talk about social gaming, my focus is on retail as being the best venue for social gaming. And the way we want to integrate mobile and i-Pads is to enable our players to create more social interaction, between us and them but also for players to communicate and share with each other.

*What can the industry associations like the WLA and EL do to encourage coopera-*

*tion between lotteries to build a powerful brand that is recognized by governments as the leader in areas like sustainability, responsible gaming, and security standards?*

**F. Paes Afonso:** Communicate, communicate, communicate. That is what our adversaries in the remote i-gambling sector do. They communicate with the press and with the government. We are losing the communications battle. And that is incredible. In terms of revenues, reputation, longevity, and public awareness, lotteries are the elephant of the industry. These remote operators are the mouse that roars and we are like the elephant who is afraid of the mouse.

The WLA, EL and CIBELAE can be the instrument for change and the vehicle to communicate our message to the press, to governments, and to international governing bodies like the European Union Commission. For our associations to be effective, they need the active support of all the lotteries in the world. They need to meet more to work out the strategies and action plans that will have an impact on public opinion and gov-

ernmental decisions. I am convinced that we can succeed at getting this message across and persuading the shapers of public policy to support our plans for sustainable growth of the industry. But it will require communication and cooperation between lotteries. That should not be as hard as we sometimes seem to make it. Look at the commercial community of internet gaming operators. These people compete with each other. They are enemies in the market-place and are often even suing each other in court. But when it comes to their political agenda, they all see that they will accomplish more by cooperating and speaking with one voice. Lotteries do not compete with each other and in fact share almost all the same values and operate with similar business models. And yet we do not collaborate as well as the commercial i-gaming operators when it comes to public relations and communicating with the shapers of public policy.

*Back in the years just prior to leaving the lottery in 2005, you were instrumental in implementing EuroMillions and also in com-*

*municating with the European Parliament about the importance of protecting the rights of member states to determine their own regulatory and taxation policy. Now you have just been appointed to the executive committee of the European Lottery association.*

**F. Paes Afonso:** Of course, there are many others who have worked hard to lead the associations throughout the years, and to great effect. Look at all that has been accomplished, especially by the European Lottery Association. The community of remote i-gaming operators was on the cusp of overturning the fundamental regulatory model in Europe and that was prevented. But there is much more that needs to be done. The debates continue. That is why we must continue to press our case with the European Commission. We need to address their concerns, propose solutions to their questions, help them resolve the trade-off between the principles of the Common Market and the need for member states to control regulation and taxation of gambling. And we need to take this message to the public and to our players as well. ♦