



UNDERSTANDING SKIN GAMBLING

A guide to what skin gambling is, how it works, the demand for skin gambling, recent controversy, the legal issues, and the key takeaways for the regulated gambling industry.

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Thanks to increasing coverage from the mainstream media and a recent rash of controversies, skin betting - online wagering conducted in digital items instead of money - has become a topic of interest to many in the gambling industry.

This white paper provides a concise but comprehensive education on the fundamentals of skin betting, the size and nature of the market for skin betting, the legal landscape, and some key takeaways for commercial gambling stakeholders.

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AN IMPORTANT NOTE

As we prepare to publish this paper (July 2016), the skin gambling industry is facing an existential threat from game developer Valve. The game developer is seeking to shut down skin betting sites, a move that appears to be meeting at least some resistance from the sites. We believe that even if Valve is successful in largely eradicating skin gambling, the product still deserves careful attention as a possible template for a new class of gambling products that will prove popular with esports fans and the new generation of gamblers they represent.

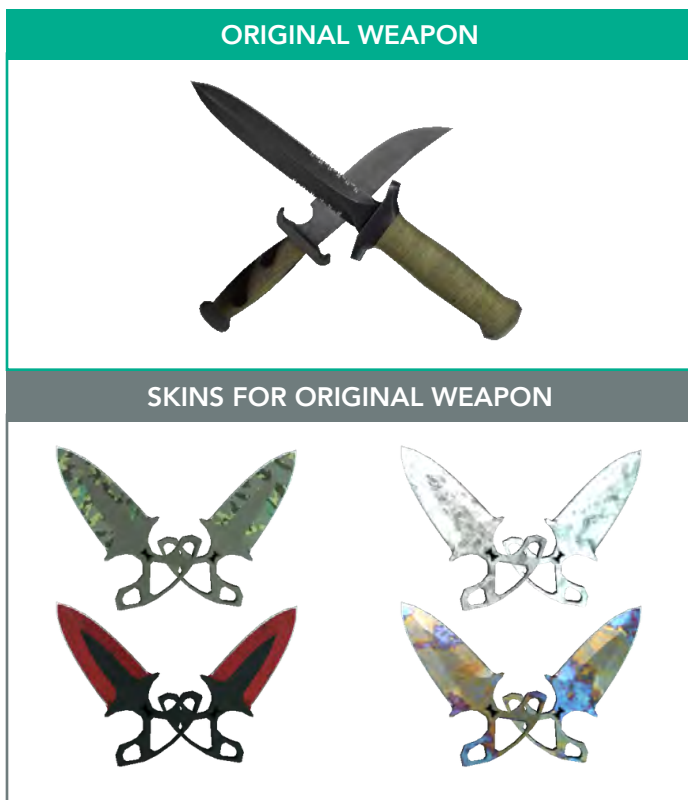
OVERVIEW

What are skins?

Skins are virtual items that can be used in games like **Counter-Strike: Global Offensive (CS:GO)**. The term “skin” is derived from the typical function of these virtual items: changing the appearance of a player’s in-game avatar, weapons, or equipment.

While a number of games employ some sort of skin system, CS:GO skins are the dominant currency in the skin betting market, accounting for over 80 percent of total wagering activity. As a result, this guide will focus on the CS:GO skin ecosystem.

For example: Below is an image of the “stock” knife used as a weapon in CS:GO. Players can opt to replace that stock knife with unique skins of the knife that change the appearance of the knife, as shown in the images to the right of the stock knife.



Note that the skins do not improve the functionality or power of the knife. The skin only changes the appearance of the knife. Skins play a purely cosmetic role.

How do players acquire skins?

There are a number of ways for players to acquire skins. In CS:GO, players can acquire skins by:

- Receiving them during gameplay.
- Receiving them as a promotional giveaway (often around major CS:GO events).
- Trading with other players.
- Purchasing skins on a variety of marketplaces.

How do people bet skins?

Forget for a moment the practical application of a skin (changing the appearance of a character in a video game) and instead think of a skin as a simple unit containing value - not unlike a casino chip.

Like a casino chip, a CS:GO skin can be traded between the player and the house. That basic functionality allows skins to serve as a de facto currency that can power basically any type of gambling product you can imagine. Here’s how it works:

- Players “deposit” a skin at a skin betting site (popular types of sites include sportsbooks, lotteries, roulette, and coin flips) by transferring the skin to the skin betting site.
- They gamble using their deposited skins (or in some sort of internal currency that the player receives in exchange for their skin).
- If they win, they’re paid in additional skins, which they “cash out” by requesting that the skin betting site transfer skins back to the player.

Once players have skins in their Steam account, they can:

- Leave the skins dormant in their inventory.
- Use the skins to change the appearance of their weapons.
- Trade skins with other players.
- Sell skins on the Steam marketplace for Steam credit (not cash) that can be used to buy other skins and games via Steam.
- Exchange skins for cash on third-party sites outside of Steam.

A flow chart of this activity is available in **Appendix A**.

Note that not all video games with skins or other virtual items allow those items to be transferred between players. Among popular esports, CS:GO and Dota 2 are unique in allowing the easy movement of virtual items between accounts.

How large is the market for skin betting?

On July 13, Valve indicated it intends to crack down on the use of its platform to facilitate skin gambling.

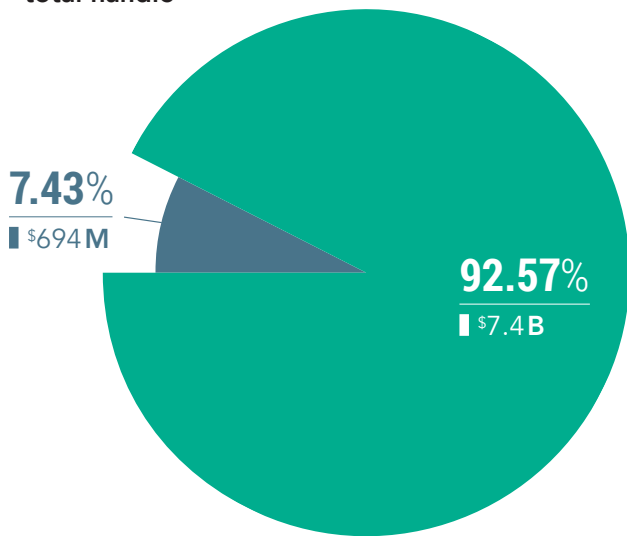
It's not entirely clear at this point how effective the crackdown will be at suppressing skin betting (a related ban from Twitch on streaming skin gambling activity will certainly help the cause, as streaming is one of the primary marketing channels for skin gambling sites). While some sites have already closed in response to Valve's announcement, many remain online. Among those that have closed, many have promised to return with products that comply with Valve's policies.

Prior to that announcement from Valve, we estimated that **\$7.4bn worth of skins** would be **wagered** worldwide by players across **all skin gambling products in 2016**. By way of contrast, we estimate that \$550mm in cash will be wagered on esports in 2016.

We are currently revising our estimates for 2016 and our projections through 2020 in the wake of Valve's decision.

ESPORTS GAMBLING PROJECTIONS 2016*

■ Skin gambling total handle ■ Cash gambling total handle



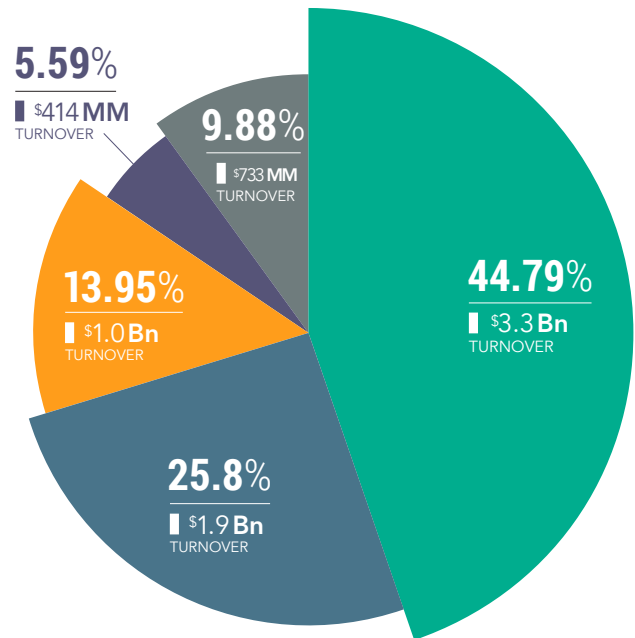
The market for skin gambling is distributed across a handful of dominant products.

Sportsbook-style betting (wagers on esports matches) is the largest vertical. The second most popular is jackpot-style games, essentially lotteries where players receive tickets based on the value of their deposited skins. Simple forms

of roulette games, coin flip games, and blackjack games make up much of the remaining turnover.

SKIN GAMBLING MARKET SIZE*

- **Sportsbooks:** Players bet skins on the outcome of esports matches, or on events within those matches.
- **Jackpot:** Players bet skins in lottery-style games.
- **Roulette:** Players bet skins in roulette-style games.
- **Coin flip:** Players bet skins on the flip of a virtual coin.
- **Other:** Raffles, rock-paper-scissors, mystery boxes, blackjack.



Notably, while skin-based slot machines do exist, they are infrequently found and appear to garner little-to-no interest from esports fans.

This diversity is one reason why skin gambling handle is so much larger than esports cash gambling handle. But even after adjusting for that difference (i.e., comparing skin-based esportsbook betting to cash-based esportsbook betting), skin gambling is still some six times larger than cash gambling.

In terms of market participants, the skin gambling industry grew quickly from a handful to hundreds of sites in the course of a year. The vast majority of those sites were variations on the basic jackpot product theme. Ultimately, we believe the bulk of handle in the skin betting industry was generated by roughly fifteen sites.

Skin gambling sites are largely unregulated and there is little transparency regarding ownership. The majority of skin gambling sites offer no user verification process, opening the industry to widespread accusations of facilitating underage gambling. While there is no available hard data on this point, there is little doubt in our minds that some material percentage of the skin gambling user base is not of legal age to gamble in their jurisdiction.

* These projections do not account for Valve's recently-announced plans to crack down on skin gambling

SKIN BETTING: INDUSTRY TIMELINE

A brief history of skin gambling

The origin of CS:GO skin betting can be traced back to August 2013, when Valve introduced the tradable skins system to CS:GO. Rudimentary gambling sites started appearing soon after. The trajectory from there is somewhat murky, but it appears that skin betting sites didn't begin to really gain traction until 2014, led primarily by sportsbook-style sites such as CSGOLounge.

Other variations popped up around the same time, but 2015 seems to be the year that witnessed the larger-scale introduction of skin gambling products like roulette, jackpot, and blackjack.

A brief list of popular skin betting sites and available products at each is available in Appendix B.

At the same time, promotion of such sites via the streams of popular esports personalities became far more prevalent, causing a significant spike in consumer use, and a subsequent spike in the number of skin gambling sites and the variety (and sophistication) of the products offered.

That set the stage for a dramatic surge in activity toward the end of 2015 that persisted - and accelerated - until the industry encountered a wave of controversies.

RECENT CONTROVERSY

MAY 2016	Skin gambling site CSGOStakes closes with no notice, failing to reimburse players who had skins or site credit still on deposit.
JUNE 2016	A popular CS:GO streamer paid to promote a skin gambling site reveals that he was told in advance by site owners when he would win or lose. This was done to make his streaming of gambling on the site "more entertaining."
JUNE 2016	A lawsuit seeking class-action status is filed against CS:GO developer Valve. The suit claims that Valve is complicit in the operation and growth of the skin gambling economy.
JUNE 2016	A major skin gambling site pulls out of the U.S. market in an apparent response to legal or regulatory concerns.
JULY 2016	Two popular esports personalities who aggressively promoted a skin gambling site are revealed to be owners of said site, a fact that was not obviously disclosed in their promotion of the site.
JULY 2016	Valve requests that skin gambling sites stop utilizing some aspects of the Steam platform.
JULY 2016	A popular roulette-style skin gambling site closes in reaction to Valve's announcement, but announces a plan and timeline for allowing players to withdraw their balances prior to full shutdown.
JULY 2016	Twitch announces a ban on streams containing skin gambling on the basis that such streams violate Valve's TOS.
JULY 2016	Esports journalist Richard Lewis raises allegations that another major esports personality maintained an undisclosed ownership stake in a skin betting site while promoting said site.
JULY 2016	Valve issues cease-and-desist notices to 23 skin gambling sites. A handful comply, but most continue to to operate.

SKIN GAMBLING AND THE LAW

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Like all things gambling, skin gambling or skin betting exists in a legal gray area.

There are three federal statutes to consult when considering the legality of gambling: the **Unlawful Internet Gambling Enforcement Act (UIGEA)**, the **Illegal Gambling Business Act (IGBA)**, and the **Wire Act**. Each statute, in its own way, prohibits interstate online gambling. These statutes were created long ago, but can and will be applied to any legal challenge involving skin gambling.

UIGEA makes it illegal for businesses to accept payment over the internet for a bet or wager that is otherwise unlawful under state law. The statute's reliance on state laws means an online gambling website can operate in a state that has legalized online gambling so long as the site limits users to that particular state – this is called intrastate gambling. When a gambling operator operates in a state that does not recognize that particular form of gambling, that operator may violate UIGEA.

IGBA is not internet specific, but does make it unlawful for a person to take part in an illegal gambling business. While this statute has its origins in the fight against organized crime, it has been applied to online gambling. Like UIGEA, IGBA requires a state law violation and imposes criminal penalties.

The Wire Act outlaws the use of telephones or other wire devices to transmit bets or wagers on sporting events. The Act does not apply to non-sports gambling. Unlike UIGEA or IGBA, the Wire Act does not rely on a state violation to apply; rather, an entity can violate the Wire Act simply through transmitting wagers on a sporting event.

As of this writing, there are no cases involving skin betting. However, several recent cases – *Mason v. Machine Zone*, *Soto v. Sky Union*, *Kater v. Churchill Downs Incorporated*, and *Phillips v. Double Down Interactive* – brought against the social gaming industry in various states may be insightful:

- In each of these cases, a consumer sued a social gaming operator by alleging the virtual coins and prizes won on the social gaming sites had real money value and that the operators were therefore guilty of violating state and federal laws prohibiting online gambling.
- In each and every one of these cases, the courts concluded that the virtual casinos (which were only a part of the social games) were not illegal gambling because the players were not wagering or winning real world money. Any money the players paid was for access to the game itself, not a wager that hung in the balance during the game of chance. Further, the prizes were only virtual tokens that could be used for gameplay with no real world value.
- Based on the lack of real world money being wagered and won, courts thus far have concluded that virtual gaming operators with virtual prizes are legal.

The statutes and relevant case law have yet to be applied specifically to skin gambling. But it stands to reason that a case alleging skin betting or gambling is illegal gambling should be treated in much the same way as the social gaming cases and presumably dismissed.

That is not to say there are not other legal vulnerabilities facing the industry. Sites should ensure that they have proper age and identity verification systems in place. Sites should also avoid misrepresentations regarding the nature of the game offered and avoid promotions that may be deemed deceptive by relevant federal and state agencies.

Gambling – whether online or in the real world – is a heavily regulated industry. Online skin gambling operators will need to navigate the significant number of federal and state laws and federal and state agencies that monitor the industry. By following the lead of online gambling sites that have come before, such as online poker and social gaming, operators can establish a new forum for esports enthusiasts to enjoy legal skin gambling.

KEY TAKEAWAYS FOR THE COMMERCIAL GAMBLING INDUSTRY

Strong demand for gambling exists among esports fans

A persistent trope in the commercial gambling industry is that millennials don't have the budget for or interest in gambling. Skin gambling explodes that assumption, at least in regards to the sub-section of the millennial generation that is engaged with esports.

The amount of handle pushed through skin betting sites in 2016 looks set to easily eclipse the amount of total handle at DFS sites in 2015 - even accounting for the impact of the controversies listed earlier.

The development of skin betting into a multi-billion dollar industry by turnover took a little over a year and happened in an almost completely organic fashion. There is simply no world in which such a rapid development occurs in such a fashion absent an intense level of inherent demand for gambling among esports fans.

That demand may not be obvious through the prism of traditional gambling

Every generation prefers to gamble in a slightly different way. The same is broadly true for every culture. The emergence of skin gambling underlines this point.

Much of the misunderstanding regarding the appetite for gambling among millennials may be a function of the commercial gambling industry failing to appreciate that they may be asking the wrong question - "do millennials want to gamble via the products I currently offer?" instead of "do millennials want to gamble?" - without realizing it.

The apparent absence of successful skin betting sites built around slot machine-style games furthers the point. The modern casino is dominated by the slot machine, so much

so that a cohort not engaging with slot machines can quickly become a shorthand for that cohort being generally disinterested in gambling. For whatever reason, the slot machine format does not appear to resonate with esports fans (even when presented in the most favorable context possible), a predisposition that seems to broadly echo throughout the millennial generation.

Focus on speed, simplicity, social (and skins)

Commercial gambling operators looking for an entry point into the market for esports betting, or those looking at betting as an amenity to attract or retain esports fans, should draw three basic lessons from the explosive growth of skin betting.

- 1. Speed:** The majority of popular skin gambling games (outside of sports betting) are rapid-fire games that resolve in a matter of seconds, with new rounds starting right as the last round concludes (or occurring in parallel).
- 2. Simplicity:** The fundamental game mechanic in popular skin gambling products tend to be hyper-simple (a coin flip, a lottery draw, a game of roulette reduced to black/red/green). This simplicity extends to the user interface. Options are minimal. Bells and whistles are all but absent.
- 3. Social:** The majority of popular skin gambling products involve players pitted against one another in a pool. The most popular skin sports betting site is a tote system. Even in games where players compete against the house, there tends to be some social element involved.
- 4. Skins:** The chance of a regulated gambling operator entering the skin gambling market at this point is obviously non-existent. But that doesn't mean regulated operators should ignore the core lesson of skin gambling: Esports fans appear to be more willing to wager with virtual items than with cash, even when said virtual items have a cash value.

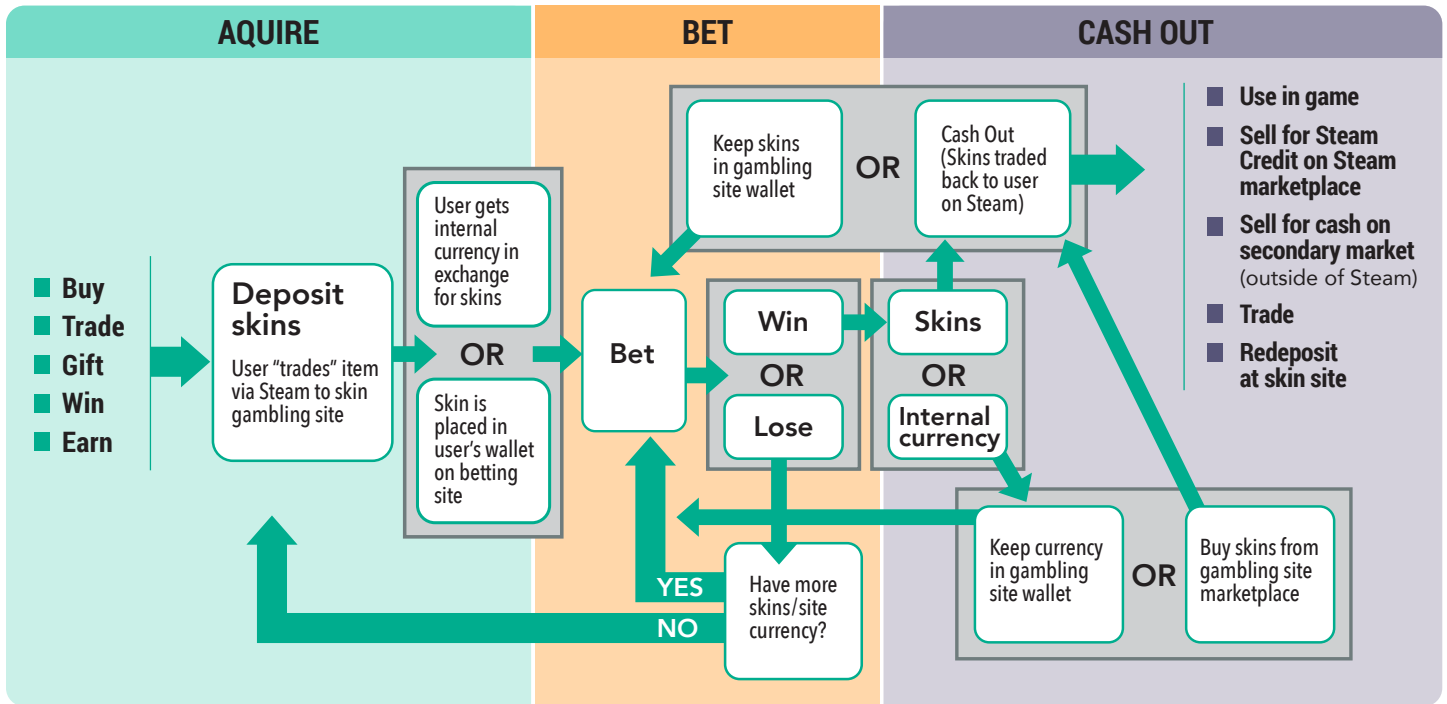


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APPENDIX A



APPENDIX B

SITE NAME	SPORTS BETTING	JACKPOT	COIN FLIP	ROULETTE	OTHER
CSGOBig		•	•	•	•
CSGOFast		•	•	•	•
CSGOJackpot		•	•		
CSGOLounge	•				
CSGOWild			•	•	
Dota2Lounge	•				
Fanobet	•			•	
Skin Arena		•	•		•
Skin Joker		•			



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