

DESCRIPTION OF PROPOSED REGULATIONS

MINIMUM INTERNAL CONTROL STANDARDS (MICS) FOR GAMBLING ESTABLISHMENTS GAMBLING FLOOR OPERATIONS AND PLAY OF CONTROLLED GAMES.

Introduction:

In general, this proposed action has been drafted in an attempt to establish uniform procedures and standards to assist the California Gambling Control Commission (Commission) and the Bureau of Gambling Control (Bureau) in meeting their oversight responsibilities under the Act, while taking into account variations in the size of gaming operations. More importantly, the proposed action is intended to provide for minimum standards that protect public health, safety and general welfare.¹ These regulations establish a baseline for Gambling Establishment (cardroom) operation, by requiring that licensees establish and implement written policies and procedures that meet or exceed the prescribed Minimum Internal Control Standards (MICS), as they relate to the established size category of the individual licensee. Establishing baseline standards helps to ensure consistency and uniformity.

Background:

The Commission's involvement in the development of MICS for cardrooms began in June 2004. A joint Commission-Bureau-Industry workshop was conducted to review preliminary draft proposals for regulations in September 2004. After consideration of the information and comments received through that workshop, the proposed MICS requirements or categories were deliberated. The conclusion was to have smaller rulemaking packages with topic-related MICS instead of one large rulemaking with many MICS included. Regulations for Gaming Activity and Additional Tables finished the rulemaking process in 2006, with the latter being adopted and approved. Subsequently, other issues arose which required the Commission to re-evaluate their regulation development priorities and work on the MICS regulations was suspended temporarily.

In September 2007, a joint Commission/Bureau MICS Regulations Workgroup was formed to continue the development of regulations to establish MICS for cardrooms. The workgroup has discussed general MICS requirements and researched MICS requirements from other states. Due to the number of subjects and complexity of the MICS requirements, the workgroup segregated the requirements into separate subject areas in order to pursue regulations in phases according to priority. Those phases and subjects, in order of priority, are:

- Phase I: General Terms, Conditions & Definitions; Policies & Procedures; Drop & Drop Collection; Count & Count Room Functions; and Cage Functions
- Phase II: Emergency Preparedness, Security & Surveillance
- Phase III: Gambling Floor Operations & Play of Controlled Games
- Phase IV: Chips, Cards & Other Gambling Equipment
- Phase V: Personnel & Tips
- Phase VI: Information Technology Systems

¹ Business and Professions Code, section 19920.

Phase VII: Adequate Financing; Player-Dealer Banks, & Jackpots

Multiple phases are being considered simultaneously and are currently in various stages of development. Phase I MICS regulations were approved by the Office of Administrative Law (OAL) on August 25, 2009 and became effective on September 24, 2009. Phase II MICS regulations are in the late stages of the rulemaking process. It is intended that each phase will be taken up, formally, in the order listed above.

Business and Professions Code section 19840 requires that the Commission and the Bureau consider the operational differences of large and small cardrooms when establishing regulations. As a result, California Code of Regulations Section 12380(d) already establishes five tiers that represent the relative size of cardrooms, based upon their number of approved gambling tables. The smallest cardrooms are identified as Tier I, while the largest ones are in Tier V. The breakdown by the number of tables is as follows:

- Tier I: 1- 5 tables
- Tier II: 6- 10 tables
- Tier III: 11- 30 tables
- Tier IV: 31- 60 tables
- Tier V: 61 or more tables

This proposed action moves into phase III of these MICS regulations (Gambling Floor Operations and Play of Controlled Games). An effort has been made to include affected parties in the development of this proposed action and careful consideration will continue to be given to their views and suggestions.

Proposed Action:

Specifically, this proposed action will make the following changes within Article 1 of Chapter 7 of Division 18 of Title 4 of the California Code of Regulations:

1. Section 12360 provides definitions for the words that govern the construction of Chapter 7. This section currently incorporates the definitions in Business and Professions Code section 19805 and includes specific definitions for the words "licensee", "security department" and "surveillance unit." This proposed action would amend Section 12360 by adding definitions for the words "gaming activity" and "house rules." These words are used in the text of proposed Sections 12391 and 12392.

Pursuant to Title 11, Section 2010(f), "gaming activity" means any activity or event including, but not limited to, jackpots, bonuses, promotions, cashpots, tournaments that is appended to or relies upon any controlled game. In the construction of proposed Sections 12391 and 12392, it is important that a *gaming activity* not be confused with a *controlled game*. Pursuant to Section 12002(c) and Business and Professions Code section 19805(g), a *controlled game* means the actual play of Poker, Pai Gow or California Games. *Gaming activities* are generally promotional in nature, while *controlled games* represent the actual play of the games being promoted. Since *gaming activity* is already defined in Title 11, for consistency purposes, proposed Section 12360(a) would merely incorporate that same definition.

Similarly, in the construction of proposed Section 12392, it is important to differentiate between “house rules” and “game rules.” Throughout the Act, *game rules* refers to those published rules for each specific game that are approved by the Bureau.² In contrast, proposed Section 12360(b) would define *house rules* as those which set general parameters for the play of all controlled games at a particular cardroom. Section 12392 would set minimum standards for the house rules of each cardroom.

This proposed action will make the following changes within Article 3 of Chapter 7 of Division 18 of Title 4 of the California Code of Regulations:

1. This proposed action would establish new Section 12391, which would require cardrooms to adopt specified minimum policies and procedures that relate to the operation of the gambling floor. These proposed policies and procedures are divided into two subsections: Subsection (a) would apply to all cardrooms, while Subsection (b) would apply only to cardrooms in Tiers II through V.

Section 12391(a)(1) would require that the areas of a cardroom in which controlled games and gaming activity are conducted be *open to the public*. This proposed regulation is consistent with Business and Professions Code Section 19841(p) which requires the Commission to adopt regulations that define and limit the area, games, hours of operation, number of tables, wagering limits, equipment and the method of gambling operations when local regulations are insufficient to protect the health, safety or welfare of residents near cardrooms. Requiring that all cardrooms be *open to the public* creates a consistent statewide standard, regardless of local requirements. This proposed regulation is also in compliance with Business and Professions Code section 19801(j) which states in part:

“To ensure that gambling is conducted honestly, competitively, and free of criminal and corruptive elements, all licensed gambling establishments in this state must remain open to the general public ...”

This proposed regulation also provides for an exception to this *open-to-the-public* rule should the provisions of Business and Professions Code section 19861 apply to any cardroom in the state. This exception permits the licensing of small (Tier I) *private* cardrooms, provided that they are located in an area that has a local ordinance allowing only private cardrooms and they existed on or before December 31, 1997. There is only one cardroom in the state that meets these criteria.

Section 12391(a)(2) would require cardrooms with a gross revenue of \$200,000 or more to have, in accordance with Title 11, CCR, Section 2050, an owner licensee or key employee on their premises during all hours of operation that has the responsibility and authority to supervise and monitor the gambling floor operation and to ensure compliance with the Act, those regulations adopted there under, and any other provision of law. Section 2050 requires that an owner licensee or key employee be on the premises, except for those cardrooms with less than \$200,000 in annual gross revenue, in which case, an owner licensee or designated employee must only be available by telephone. This proposed regulation expands Section 2050 by adding the responsibility and authority of the owner licensee or key employee to supervise and monitor of the gambling floor operation. This proposed regulation is also consistent with Business and Professions Code sections

² Business and Professions Code, sections 19826, subdivision(g) and 19841, subdivision (g).

19827(a) and (b) which authorize the Bureau to demand access to controlled areas and records of a cardroom for the purposes of determining compliance with the Act or its regulations. An owner or key employee is often the only person at the cardroom who has access to these controlled areas or records. Further, Business and Professions Code section 19841(h) mandates that the Commission's regulations prescribe minimum procedures for licensees to exercise effective control over their fiscal and gambling affairs, while section 19841(o) mandates that the Commission's regulations, consistent with the purposes of the Act, restrict, limit or otherwise regulate any activity that is related to controlled gambling. Finally, this proposed regulation promotes *compliance with the Act* and its regulations by placing someone in charge of the task. In other words, every cardroom would be required to have someone in charge of protecting the health, safety and welfare of its patrons.³

Section 12391(a)(3) would, with the exception of house prop players and public relations players, prohibit an employee of a cardroom from participating in any controlled game or gaming activity during their work shift. Further, Section 12391(a)(4) would prohibit a licensee from requiring that their employees play controlled games at the cardroom during non-work hours. Whether in a poker game or in a game with a player-dealer position, it is important that patrons do not have the perception that the house has a financial interest in any controlled game, as is prohibited by the Act and the Penal Code.⁴ More specifically, the Act prohibits a cardroom from having any interest, whether direct or indirect, in the funds that are wagered, lost, or *won* by licensed third-party providers of proposition player services.⁵ If the legislature was clear in their intention to not allow cardrooms to have any interest in funds that are won by a third party, then surely they would object to cardrooms having an interest in funds won by their own employees. Business and Professions Code section 19841(o) mandates that the Commission's regulations, consistent with the purposes of the Act, restrict, limit or otherwise regulate any activity that is related to controlled gambling. Further, section 19841(p) mandates that the Commission's regulations define and limit the method of gambling operations when the Commission and the Bureau determine that local regulations are insufficient to protect the health, safety or welfare of residents near cardrooms. Since most local ordinances do not address this issue, it is appropriate for the Commission to propose this regulation. Finally, this proposed regulation will help to keep the play of controlled games honest and fair to patrons.⁶ The Bureau recently worked a case where an on-duty chip runner was playing at the table with funds from the chip tray, and repeatedly went back to the cage for more chips; providing, what appears to be, unlimited access to funds with which to play. The Bureau has found that there is a high perception from patrons that some cardrooms are funding employees to play controlled games in an effort to win the pots.

Section 12391(a)(5) would prohibit a licensee from playing in any controlled game on the premises of their own cardroom. This regulation has been proposed for the same reasons as stated above for Sections 12391(a)(3) and (4). Further, Bureau staff has identified several areas of concern which necessitate prohibiting licensees from playing in a game at their own cardroom, including but not limited to:

³ Business and Professions Code section 19920.

⁴ Business and Professions Code section 19801, subdivision (a) and Penal Code section 330.

⁵ Business and Professions Code section 19984, subdivision (a).

⁶ Business and Professions Code sections 19801, subdivision (g), 19841, subdivision (b), 19914, subdivision (a), paragraph (2), 19920 and 19924.

- Appearance of an unfair house advantage,
- Appearance of conflict of interest, the house having a more active interest in the outcome of the game(s),
- Use of house funds to play a controlled game,
- Co-mingling of house funds with an owner's personal funds,
- Poker players that represent the house may have access to unlimited funds with which to play, resulting in an unfair advantage over other players because they have the ability to wait longer for more favorable hands from which to win the pots, and
- The Bureau routinely receives complaints from patrons alleging that licensees are winning jackpots and other promotional contests.

Section 12391(a)(6) would require a licensee to maintain a table log which must contain specified information. Section 12391(a)(7) would require that a shift supervisor or key employee sign and certify the table log on a daily basis and Section 12391(a)(8) would require that table log sheets be stored chronologically in a binder. The following information must be entered into a table log for each day and shift:

- (A) The tables that were open,
- (B) The games that were played, including table limits and collection rates,
- (C) The total time that games were played at each table,
- (D) The personnel assigned to each table, and
- (E) The name of each house prop player and public relations player on duty.

This table log will help to encourage compliance with cardroom revenue reporting and drop collection requirements by documenting the hours of play and the games played at each table.⁷ Further, Business and Professions Code section 19841(h) mandates that the Commission's regulations prescribe minimum procedures for licensees to exercise effective control over their fiscal and gambling affairs, and section 19841(k) mandates that the Commission's regulations specify forms for reporting the results of gambling operations. These table logs will also assist Bureau staff in verifying compliance with laws and regulations that require controlled games to be pre-approved by the Bureau.⁸

Section 12391(a)(9) would require that the name of each controlled game or gaming activity, the table limit(s), and the collection rate(s) applicable to a each table be displayed on that table. It is important for patrons to know the name of the game that is being played, along with the wagering limits and the cost of playing each hand. This basic information is easily displayed and is important when a patron is deciding whether or not to play. Business and Professions Code section 19841(b) requires that the Bureau approve game rules to ensure fairness to patrons. Further, section 19841(p) mandates that the Commission's regulations define and limit the method of gambling operations when the Commission and the Bureau determine that local regulations are insufficient to protect the health, safety or welfare of residents near cardrooms. The posting of this basic information is

⁷ Business and Professions Code sections 19841, subdivision (h), and 19951, subdivision (d); California Code of Regulations, Title 4, Sections 12357, subsection (b), 12384 and 12401.

⁸ Business and Professions Code section 19826, subdivision (g); California Code of Regulations, Title 11, Sections 2038 and 2070, subsection (b).

necessary for gambling operations to be conducted fairly, honestly and in the interest of the welfare of patrons.⁹

Section 12391(a)(10) would prohibit a licensee from having on the gambling floor more gambling tables than that which is authorized by the license. The number of tables on the gambling floor of a cardroom is an important benchmark when considering the amount of controlled gambling that is permissible within the State of California.¹⁰ While the number of permissible tables is primarily determined by local jurisdictions, it remains the Commission and Bureau's responsibilities to ensure that licenses are only issued to, and maintained by, those cardrooms that adhere to these limits.¹¹

Section 12391(a)(11) would require that a cardroom licensee adhere to the provisions of a contract with a provider of third-party proposition player services. State laws and regulations allow for the provision of proposition player services, but only if a Bureau approved contract exists between the cardroom and the provider of proposition player services.¹² This proposed regulation would clarify that a cardroom licensee is required to adhere to the terms of this contract, once it is approved by the Bureau.

Section 12391(a)(12) would require that the purchase or redemption of chips be transacted only by designated cardroom employees at a cage or on the gambling floor who has received the training required by section 103.64 of Title 31 of the Code of Federal Regulations. This federal regulation requires cardrooms to train employees on the reporting requirements for cash transactions in excess of \$10,000 and other cash transactions that are considered unusual or suspicious. This regulation would also require that a cardroom's policies and procedures prohibit providers of third-party proposition player services and gambling businesses from selling chips to patrons or redeeming chips from patrons.

Section 12391(a)(13) would require a licensee to include in their policies and procedures a provision that ensures compliance with Section 12404, which requires that cash transactions in excess of \$10,000 and other unusual or suspicious transactions to be reported in accordance with specified federal and state laws and regulations.

The proposed regulations in paragraphs (12) and (13) will help to ensure compliance with federal and state laws and regulations that relate to the reporting of large cash transactions.¹³ The Financial Crimes Enforcement Network (FinCEN), of the United States Department of the Treasury, is a government-wide multisource financial intelligence and analysis network tasked with the administration of the Bank Secrecy Act. Based on revenues deposited into individual cardroom bank accounts, FinCEN estimates that 85-90% of Cash Transaction Reports (CTRs) and Suspicious Activity Reports (SARs) required of the California cardroom industry under the Bank Secrecy Act

⁹ Business and Professions Code, sections 19801, 19823, 19826, 19841, 19920 and 19971.

¹⁰ Business and Professions Code sections 19801, subdivision (l), 19862, subdivision (b), and 19961, subdivision (b).

¹¹ Business and Professions Code sections 19801, subdivision (l), 19826, subdivision (c), 19841, subdivision (p), 19860, subdivision (a), paragraph (5), and 19960, subdivision (c), paragraph (2), subparagraph (E).

¹² Business and Professions Code section 19984, subdivision (a); California Code of Regulations, Title 4, Section 12200.9, subsection (a), paragraph (1).

¹³ United States Code, Title 31, sections 5313 and 5314; Code of Federal Regulations, Title 31, Sections 103.21, 103.22, 103.23, 103.63 and 103.64; Penal Code section 14162, subdivision (b); California Code of Regulations, Title 4, Section 12404.

and the USA Patriot Act were not being reported. Citing concerns about a widespread opportunity to launder large amounts of cash through the California cardroom industry, consistent compliance with financial reporting requirements is essential to combating crime. The key reason to require that large purchases and redemptions of chips occur only at the cage is to better ensure mandatory SARs/CTRs reporting, and provide regulatory audit, compliance and enforcement staff better control and monitoring of large cash transactions in the cardrooms. Currently, these types of transactions occur at varying areas of the cardrooms: at the table, with the chip runners, at the satellite cages and at the main cashier cage. It is clear that these multiple locations of large cash/chip transactions could be a major contributing factor to any noncompliance with FinCEN reporting requirements. This proposed regulation is consistent with Business and Professions Code section 19841(d) which mandates that the Commission's regulations require licensees to report and keep records of these large cash transactions. It is important that cardrooms develop specific procedures for their employees to follow that will ensure compliance.

Section 12391(a)(14) would require a licensee to develop specified policies and procedures relating to providing complimentary items or services to patrons, including:

- (A) Criteria for awarding and redeeming complimentary items or services,
- (B) Requiring owners or key employees to approve complimentary items or services,
- (C) Controlling access to the personal information of patrons participating in player rewards programs,
- (D) Keeping records of all complimentary items or services provided to patrons, and
- (E) Preparing a quarterly report of these complimentary items or services.

Business and Professions Code section 19841(b) mandates that the Commission's regulations provide for the approval of game rules by the Bureau to ensure fairness to patrons. Section 19841(g)(2) mandates that the Commission's regulations govern the cashing or redemption of negotiable instruments. Section 19841(h)(3) mandates that the Commission's regulations require cardrooms to exercise effective control over their internal fiscal and gambling affairs by keeping records of transactions, operations, and events. Finally, section 19841(o) mandates that the Commission's regulations, consistent with the purposes of the Act, restrict, limit or otherwise regulate any activity that is related to controlled gambling. This proposed regulation will help to protect the personal information of patrons and ensure that complimentary items and services are awarded in a fair and honest manner.¹⁴

Section 12391(a)(15) would prohibit a licensee from providing funds to another licensee, employee or patron of the cardroom for the purposes of playing a controlled game, except when extending credit to patrons, third-party providers of proposition player services and gambling businesses, pursuant to Section 12388. As stated above, it is important that patrons do not have the perception that the house has a financial interest in any controlled game, as is prohibited by the Act and the Penal Code (See reasons for proposed Section 12391(a)(3) above).

¹⁴ Business and Professions Code sections 19801, subdivision (g), 19823, 19826, 19841, subdivision (b), 19920, 19924 and 19971.

Section 12391(b) would require Tier II through V cardrooms to have a specified number of employees to oversee gambling operations, based on the number of rooms or gambling tables. The number of required employees would be as follows:

- (1) One key employee for each separate room where controlled games are being played,
- (2) One employee for every ten or fewer poker tables in operation, and
- (3) One employee for every five or fewer California game tables in operation.

Business and Professions Code, section 19841(h) mandates that the Commission's regulations prescribe minimum procedures for licensees to exercise effective control over their gambling affairs. By providing oversight responsibilities, this proposed regulation promotes compliance with the Act and its regulations, helps to provide for a more secure environment for patrons, and helps to ensure that games are played honestly and fairly.¹⁵

Section 12391(c) would require cardrooms to implement the provisions of Section 12391 no later than six months following the effective date of the regulation. This will provide licensees with adequate notice and sufficient time to develop appropriate policies and procedures in compliance with these newly adopted standards and requirements.

2. This proposed action would establish new Section 12392, which would require cardrooms of all tiers to adopt specified minimum policies and procedures that relate to the play of controlled games. More specifically, this section would require the following:

Section 12392(a) would require cardrooms to adopt and implement house rules that ensure the fair and honest play of controlled games and gaming activity. This section would also require that the house rules only allow those games that are permitted by local ordinances and state and federal laws and regulations. Finally, this section would require house rules to be readily available and provided to patrons and the Bureau upon request.

Section 12392(b) would require that the house rules address player etiquette and other general rules so as to ensure the orderly conduct of controlled games.

Section 12392(c) would require that, during the play of a hand, the house rules prohibit players from speaking in a language that is different than that which is customarily spoken in that cardroom, unless all persons at the table, and the key employee, understand and agree to the use of a different language.

Section 12392(d) would require that the house rules address the following situations as they may apply in the play of a controlled game:

- (1) Customer conduct,
- (2) Table policies,
- (3) Betting and Raising,
- (4) "Misdeals,"

¹⁵ Business and Professions Code sections 19801, subdivision (g), 19823, 19826, 19841, subdivision (b), 19920, 19924 and 19971.

- (5) Irregularities,
- (6) "The Buy-In,"
- (7) "Tied Hands,"
- (8) "The Showdown,"
- (9) Player Seating and Seat Holding, and
- (10) Patron Disputes.

By requiring that every cardroom have house rules, Section 12392 will help to ensure that controlled games and gaming activities are conducted honestly and fairly and that cardroom activity does not endanger the health, safety or welfare of the public.¹⁶ House rules help to keep one player from having an unfair advantage over another, and help to prevent cheating. To ensure fairness to cardroom patrons, Business and Professions Code section 19841(b) mandates that the Commission's regulations provide for the approval of game rules by the Bureau. Section 19841(h) mandates that the Commission's regulations prescribe minimum procedures for licensees to exercise effective control over their gambling affairs; and section 19841(p) mandates that the Commission's regulations define and limit the games and the method of gambling operations when the Commission and the Bureau determine that local regulations are insufficient to protect the health, safety or welfare of residents near cardrooms. Finally, it is important that the house rules do not permit the operation of games that are prohibited by local ordinance. The Bureau has investigated a recent case where a local ordinance was changed to prohibit a specific game, and the cardroom attempted to continue operation of the game because the Bureau had approved it in the past.

Section 12392(e) would require cardrooms to implement the provisions of Section 12392 no later than six months following the effective date of the regulation. This will provide licensees with adequate notice and sufficient time to develop appropriate policies and procedures in compliance with these newly adopted standards and requirements.

¹⁶ Business and Professions Code section 19801, subdivision (g), 19823, 19826, 19841, subdivision (b), 19920, 19924 and 19971.