CALIFORNIA GAMBLING CONTROL COMMISSION

FINAL STATEMENT OF REASONS

MINIMUM INTERNAL CONTROL STANDARDS (MICS) FOR GAMBLING ESTABLISHMENTS: EXTENSION OF CREDIT AND CHECK CASHING

CGCC-GCA-2009-05-R

HEARING DATE: July 21, 2009

SUBJECT MATTER OF PROPOSED REGULATIONS: Minimum Internal Control Standards (MICS) for Gambling Establishments: Extension of credit and check cashing.

SECTIONS AFFECTED: California Code of Regulations, Title 4, Division 18, Chapter 7, Article 3, amend Section 12388.

UPDATED INFORMATION:

The Initial Statement of Reasons, as published on May 21, 2009, is included in the file and is incorporated as if fully set forth in this section. The information contained therin is complete and, except as described below in the section entitled "Proposed Action," no changes have been made to the proposed regulations that would warrant any changes in that information.

Proposed Action:
This proposed regulatory action amends existing Section 12388 by providing the following clarifying details concerning the extension of credit and check cashing:

Section 12388(a) currently prohibits cardrooms from extending credit to a gambling business or a provider of third-party proposition player services (TPPS), when that credit is to be used to play a game that has a player-dealer position. These amendments would specify that these credit restrictions apply to an *owner, supervisor, player or other employee* of a gambling business, and to a TPPS that is under *contract* with that cardroom. These changes would also specify that a cardroom cannot extend credit to an employee to act as a house prop player or public relations player in *any controlled game*. These amendments help to further refine and clarify the terms under which the extension of credit is prohibited.

Section 12388(a)(2) currently requires licensees, prior to extending credit to a patron, to positively identify credit applicants. These changes would delete the word *positively*, as this may set an unachievable standard, since some persons may go to great lengths to disguise their identity.

The contents of the new Section 12388(a)(3) were previously included with Section 12388(a)(2); however, they were separated in order to provide more clarity regarding standards for assessing the credit worthiness of patrons. By separating out the assessment of a patron's credit worthiness, this change clarifies that the assessment is not limited solely when extending credit to a patron *for the first time*. This new paragraph (3) continues to provide three options for assessing a patron's credit worthiness, which continue to be listed in subparagraphs (A), (B) and (C).

Section 12388(a)(3)(A), (previously (a)(2)(A)), currently requires that licensees ensure that the patron is credit worthy by assessing the patron's credit information on a credit application. These amendments would better clarify that the cardroom must *verify* patron information and assess the patron's *credit worthiness*. They help to satisfy industry recommendations that the credit application process include an actual assessment of the patron's credit worthiness.

Section 12388(a)(3)(C), (previously (a)(2)(C)), currently provides for the utilization of previous credit transactions as one of the options for assessing a patron's credit worthiness. These amendments would clarify that this option applies *only* when the patron actually has a *credit history* with that cardroom.

To conform to the changes noted above, the subsequent paragraphs of Section 12388(a) have been renumbered by this action.

Section 12388(a)(7), (previously (a)(6)), requires that a copy of any consumer credit report obtained by the licensee be kept on file with the cardroom. These amendments would require that a copy of a patron's credit report be kept on file with the cardroom only if the credit report option was used to approve the credit, and kept only for as long as that patron's credit account is open. This helps to clarify that copies of credit reports must be kept on file only when they have been obtained using the *credit report* option for credit approval.

Section 12388(c) currently prohibits cardrooms from extending additional credit to a person who is delinquent in their existing loan payments by more than 90 days. These amendments would require that the determination of payment delinquency be based on the terms of the *original* credit agreement, preventing the cardroom from changing the terms to avoid a delinquency.

Sections 12388(f) currently prohibits a licensee from allowing a patron to redeem, reclaim or repurchase an un-deposited personal check and replace it with another personal check, unless the patron is approved for credit and the amount of the check to be replaced is within the patrons approved credit limit. The amendments to Section 12388(f) would add the word *replace* to a list of ways that a patron may present one check to a cardroom in an effort to take back a previously wtitten check. Theses amendements would also specify that once a patron replaces a personal check with another personal check, the patron cannot further replace the check with any more personal checks. That is to say, a personal check can only be replaced *once* with another personal check. If that replacement personal check were to be dishonored, the cardroom would not be allowed to accept another personal check. Instead, the cardroom would need to demand payment in another form, such as cash or a cashier's check. Finally, these amendments would exempt from the requirement that patrons be approved for credit when replacing personal checks

that have not been deposited within three banking days of receipt, and when replacing a dishonored check. These amendments were included into Section 12388 by divided Subsection (f) into three paragraphs: (1), (2) and (3). These amendments will help to align subsection (f) with other regulations that require cardrooms to consider a check an extension of credit if it is not deposited within three days (re. § 12388(e)). These amendments will also help to reduce cardroom debt by allowing patrons to replace a check that has been dishonored by the bank, without going through a credit approval process. However, by allowing a patron to replace a dishonored personal check with another personal check only once, these amendments will also help to discourage problem gambling by not allowing patrons to continually float bad checks to support their habit. It is for this reason that some local jurisdictions prohibit cardrooms from extending credit to patrons. These amendments will help to keep cardrooms from disguising *credit* transactions as *check* transactions in those areas of the state that prohibit the extension of credit.

Section 12388(g)(1)(E) currently requires that checks be made payable to the cardroom; or in the case of a third party check, endorsed over to the cardroom. These amendments would delete the requirement that a check be made *payable* to the cardroom. This change would leave subparagraph (E) with only the requirement that third party checks be *endorsed over* to the cardroom, allowing regular checks to be made payable to *cash*.

Section 12388(g)(2) currently states that, if a cardroom cashes checks for patrons, they must examine an unexpired government-issued photo identification of the patron. If the patron has not been approved for credit, identification information must also be recorded. If the patron's identification information is already on file with the licensee, which includes a *photo* of the patron, then retrieval and examination of this file would satisfy the provisions of paragraph (2). These amendments would delete the requirement that the identifying information retrieved from the cardroom's files contain a *photo* of the patron. These changes would also exempt the cardroom from examining photo identification if the patron is already approved for either credit or *check cashing*. These amendments help to further refine, clarify and simplify the requirements for patron identification when cashing checks.

In general, these proposed amendments have been drafted in an attempt to further establish and/or refine uniform procedures and standards. These amendments strive to accommodate industry concerns, while simultaneously allowing the California Gambling Control Commission (Commission) and the Bureau of Gambling Control (Bureau) to achieve their oversight responsibilities under the California Gambling Control Act (Act). Perhaps more importantly, the proposed action is intended to assist cardrooms in safeguarding their assets, protecting patrons and their property, and maintaining the integrity of games and gaming. These proposed amendments also help to establish realistic baselines for cardroom operation, by requiring that licensees implement specified written policies and procedures that regulate the extension and collection of credit and the cashing of patron checks. Establishing baseline standards help to ensure consistency and uniformity.

REQUIRED DETERMINATIONS:

Local Mandate:
A mandate is not imposed on local agencies or school districts.

Small Business Impact:
The Commission has determined that the proposed regulatory action may affect small businesses if any licensed gambling establishment qualifies as a small business and does not already have internal control standards in place which satisfy the minimum standards proposed by these regulations.

Consideration of Alternatives:
No reasonable alternative to the regulation would be either more effective in carrying out the purpose for which the action is proposed or would be as effective and less burdensome to affected private persons than the proposed regulation.

Set forth below are the alternatives that were considered and the reasons each alternative was rejected:

No reasonable alternative has been considered or otherwise identified and brought to the attention of the Commission.

COMMENTS, OBJECTIONS OR RECOMMENDATIONS / RESPONSES:

The following comments/objections/recommendations were made regarding the proposed action, either in writing or orally, during the public comment periods and/or at the public hearing:

A. 45-Day Comment Period Ending July 21, 2009

The following comments/objections/recommendations were made regarding the proposed action, either in writing during the 45-day comment period that ended on July 21, 2009, or orally at the public hearing that was held on July 21, 2009.

1. Regarding these proposed regulations in general:

    a. David Fried – California Gaming Association (CGA): The CGA is in agreement with the proposed regulations, and appreciates staff's efforts to simplify the regulations and make them easier to implement.

    Response: This expression of support was accepted and considered in the adoption of the proposed action.

b. Alan Titus – Artichoke Joe's: The Act expresses concern with gambling addiction.[1] The Act also requires the Commission to adopt regulations on the extension of credit.[2] The proposed regulations fail to place limits on credit.

Response: This comment was rejected. Section 12388 is already established in law. It prohibits or restricts credit to various types of players and licensees, it establishes credit application criteria, and considers various types of check cashing as extensions of credit. These proposed changes to section 12388 are meant only to refine this existing regulation.

2. As amended by this action, Section 12388(a) would prohibit a licensee from extending credit to an *owner, supervisor, player or other employee* of a gambling business or provider of third-party proposition player services (TPPS) to play a game that has player-dealer position. These changes would also apply this credit restriction to a TPPS only when the TPPS is under *contract* with the cardroom. Finally, these changes would specify that a cardroom cannot extend credit to a "house prop player" or "public relations player" when the credit is to be used in a game with a *player-dealer position*.

a. Bureau of Gambling Control (Bureau): As a result of a recent investigation, the Bureau recommends that credit not be extended to "house prop players," for use in any controlled game. The current language of this regulation only pertains to controlled games with a player-dealer position, which would exclude poker games. The recent investigation involved a key employee being allowed to use house money to play poker, resulting in a house banking allegation. To avoid these house banking issues, the regulation should prohibit the extension of credit to employees to act as a "house prop player" or "public relations player."

b. David Fried- CGA: "House prop players" play poker games. Poker is not a banking game, has no player-dealer position, and as such, presents no opportunity for house banking. Like regular patrons, the extension of credit to "house prop players" can help prevent problems such as follow-home robberies.

Response (a. & b. above): The Bureau's comment was accepted, and the proposed regulation amended to prohibit a licensee from extending credit to an employee to act as a "house prop player" or "public relations player," for use in *any* game.

c. Alan Titus – Artichoke Joe's: The proposed amendment clarifies that the licensee cannot lend monies to an owner, supervisor, player or other employee of a gambling business that is occupying a player-dealer position; however, the present tense "is occupying" is not clear. Does this apply only while the gambling business employee is actually seated at the table? We think the regulation should simply prohibit any and all loans from the cardroom to any licensed gambling business, the same as with TPPS.

[1] Business and Professions Code, subdivision (c) of section 19801.
[2] Business and Professions Code, paragraph (1), subdivision (g) of section 19841.

Response: This comment was rejected. The fundamental difference between a gambling business and TPPS is that a TPPS is a party in a contract with the cardroom. In contrast, a gambling business may enter the cardroom with little or no notice to, or prior knowledge of, the cardroom employees. As a result, the language that restricts credit to these different types of licensees is tailored to their particular circumstances. The gambling business restriction is worded more in the present tense, whereas the TPPS language acknowledges a prior contract.

Further, this proposed regulation has the same restriction on credit to a gambling business as it does for a TPPS. In either case, a licensee cannot provide them credit to play a game that has a player-dealer position.

3. Section 12388(a)(1) requires the licensee to establish a method for determining the maximum amount which will be advanced to a patron, changes in the amount of credit, the maximum time an extension of credit will be outstanding, and repayment terms.

   a. Alan Titus – Artichoke Joe's: Nothing in this regulation or in any other regulation requires that a licensee actually set maximum credit limits, maximum times for repayment, or repayment terms.

      Response: This comment was rejected. No changes have been proposed for paragraph (1) of subsection (a) as this section already requires licensees to establish applicant standards for the extension of credit, changes in the credit amount, the maximum time an extension of credit will be outstanding, and repayment terms.

      Further, specific repayment requirements to the degree preferred by this commenter may not be flexible enough for the business model of many cardrooms. These regulations require credit restrictions and procedures for California cardrooms *for the first time*. This initial effort is meant to be less intrusive upon the business practices of cardrooms until such time as the Commission determines that more restrictive regulations should be established. At this time, more restrictive regulations may not be necessary or justified.

4. Section 12388(a)(2) requires cardrooms to *verify* applicant information and *assess* the applicant's credit worthiness before granting credit to a patron. Changes to this section also allow a cardroom to use information from previous credit transactions *only* when a patron actually has a credit history with that cardroom. Finally, these proposed changes would delete the word "*positively,*" as it is unnecessary when referring to the requirement that the cardroom identify credit applicants.

   a. Alan Titus – Artichoke Joe's: This regulation appears to require that prior to extending credit to a patron for the first time, certain steps are undertaken to ensure that the person is creditworthy. We think application of the regulation only to patrons extended credit for the first time is too limited.

Response: This comment was accepted and amendments made that will separate *patron identification* requirements for first time credit applicants from the *creditworthiness assessment* for all credit applicants, making the two separate paragraphs within Subsection (a). This change would make the second sentence of paragraph (2) a separate paragraph *(3)*, clarifying the fact that subparagraphs (A), (B) and (C) apply to all credit applicants.

The second sentence of paragraph (2) has always been independent of the first sentence and is meant to apply to all credit applicants, as evidenced by the introductory words *in addition*, and further evidenced by subparagraph (C) which can only apply to *non-first-time* credit applicants.

5. Section 12388(a)(2)(A) clarifies that the cardroom must obtain and verify certain patron information and use the information to assess the patron's financial situation and credit worthiness.

   a. Alan Titus – Artichoke Joe's: The regulation fails to require that certain vital information be obtained. Credit applications commonly request bank information. Moreover, income information is meaningless without information about financial debts and obligations.

      Response: This comment was rejected. Subparagraph (A) already requires bank information. Further, these regulations require the licensee to establish the method by which they determine creditworthiness. More specific detailed information to the degree preferred by this commenter may not be flexible enough for the business model of many cardrooms. These proposed regulations require cardrooms to establish credit application procedures *for the first time*. This initial effort is meant to be less intrusive upon the business practices of cardrooms until such time as the Commission determines that more restrictive regulations should be established. At this time, more restrictive regulations may not be necessary or justified.

6. Section 12388(a)(2)(C) allows a cardroom to use the *previous credit transactions* method of credit approval *only* when a patron actually has a credit history with that cardroom. Prior transactions between the cardroom and the patron must be reviewed to determine if the patron has paid timely and there is a reasonable basis for extending the credit amount.

   a. Alan Titus – Artichoke Joe's: This subsection seems to contradict section 12388(a)(2), which applies only when credit is being extended to a person for the first time. We suggest changing section 12388(a)(2) and leaving this section as proposed.

      Response: This comment was accepted. See response 4.a. above for Section 12388(a)(2).

7. Section 12388(c) requires that a determination of payment delinquency be based on the terms of the original credit agreement, preventing the cardroom from changing the terms

to avoid a delinquency. This section also prohibits additional credit for persons who are delinquent on their payments for more than 90 days.

a. Alan Titus – Artichoke Joe's: Instead of 90 days, if a borrower is delinquent on a loan repayment, even for just a few days, they should not be allowed further credit. Further, these regulations should prohibit demand notes and require that loans be repaid through a payment schedule or on dates certain.

Response: These comments were rejected. There may be many understandable circumstances that could result in a payment delinquency of just a few days, including illnesses, vacations, etc. Further, specific repayment requirements to the degree preferred by this commenter may not be flexible enough for the business model of many cardrooms. These regulations require credit restrictions and procedures for California cardrooms *for the first time*. This initial effort is meant to be less intrusive upon the business practices of cardrooms until such time as the Commission determines that more restrictive regulations should be established. At this time, more restrictive regulations may not be necessary or justified.

8. Section 12388(f) prohibits a cardroom from allowing a patron to, three or more banking days after receipt, redeem, reclaim or repurchase a personal check and replace it with another personal check, unless the patron is approved for credit and the amount of the check to be replaced is within the patrons approved credit limit.

a. Commission Chairman Shelton/Commissioner Vuksich: Patrons should be prohibited from replacing one bad check with another, over and over again.

b. David Fried- CGA: The CGA has previously recommended that patrons be allowed to replace a check at least once. However, cardrooms should be allowed to accept a check that is intended to replace a dishonored check as many times as is necessary to clear the dishonored check.

Response (a. & b. above): These comments were accepted in part, and Section 12388(f) amended to allow a patron to replace a personal check only once.

B. First 15-Day Change Comment Period Ending August 17, 2009

The following comments/objections/recommendations were made regarding the proposed action, during the first 15-day change comment period that ended on August 17, 2009.

1. Section 12388(a) prohibits a cardroom from extending credit to an employee to act as a "house prop player" or "public relations player" in any controlled game.

a. David Fried- CGA: The Bureau's arguments about game strategy and play are misplaced. There is no legal reason why a cardroom cannot extend credit to a "house prop player" for use in a poker game. "House prop players" are there to keep a game

going that may otherwise end because of too few players. Once a game is "active," the "house prop player" will withdraw from the game. Contrary to the Bureau's notions, "house prop players" do not have unlimited funds available to them from the cage. "House prop players" usually play in poker games that have a wager limit, so chip counts are not as decisive as may be the case in other games. Further, playing recklessly with large sums of money would only serve to excite other players, not intimidate them.

Response: This comment was rejected. 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 the game. Business and Professions Code section 19984(a) states in part:

> *"… in no event shall a gambling establishment or the house have any interest, whether direct or indirect, in funds wagered, lost, or won."*

To help reinforce this provision, in accordance with Business and Professions Code section 19984(c), the Commission has established California Code of Regulations, Title 4, Division 18, Chapter 2.1, Section 12200.7(e), which states, in part:

> *"(e) A proposition player contract shall be consistent with the provisions of Business and Professions Code section 19984, subdivision (a), prohibiting a gambling establishment or the house from having any interest, whether direct or indirect, in funds wagered, lost, or won. No proposition player contract shall be approved that would permit the house to bank any game in the gambling establishment."*

These laws and regulations do not specify what *type* of game is being played, whether it is poker or a game with a rotating player-dealer position. They simply state that the cardroom cannot have any interest, whether direct or *indirect*, in the funds wagered, lost or won.

Although the statutes and regulations noted above apply only to *licensed* Third-Party Providers of Proposition Player Services, they are clear attempts to avoid any inference to the public that the house may be banking games through other players, which is prohibited by Penal Code section 330 and Business and Professions Code section 19806. These third party laws and regulations provide the Commission with the necessary guidance to establish additional regulations which would insure that cardrooms do not have any interest in funds wagered, lost or won through use of a house prop player. If the legislature was clear in their intention to not allow cardrooms to have any interest in funds wagered by a third party, then surely they would object to cardrooms having an interest in funds wagered through their own employees (i.e. house prop players).

Section 12388(a) was originally established, and is now being amended, under the broad authority provided by Business and Professions Code sections 19840 and

19841(g). The guidance provided by the third party laws and regulations noted above prohibit even an *indirect* interest in the funds *wagered* at the gambling table. There may be a myriad of ways that a cardroom could provide or loan money to a house prop player in an effort to disguise the house's financial interest in the game, whether it be poker or a game with a rotating player-dealer position. As a result, these amendments to Section 12388(a) prohibit credit to employees to act as a house prop player *in any controlled game*.

2. Section 12388(f) prohibits a cardroom from allowing a patron to redeem, reclaim or repurchase a personal check with another personal check, unless the patron is approved for credit and the amount of the check to be replaced is within the patrons approved credit limit. This restriction does not apply to personal checks that have not been deposited within three banking days of receipt, or dishonored checks. Finally, a subsequent personal check used by a patron to replace a previous personal check may not be replaced with another personal check at any time after receipt by the licensee.

   a. Charles Bates- Bay 101: At the end of play, a patron should be allowed to redeem a personal check written earlier with a combination of their winnings, chips and a smaller check for the balance. This is a sound business practice, since it reduces the chances of a bounced check. It also represents sound money management on the part of the patron. The redemption of a personal check with another personal check should be allowed if it reduces the cardroom's outstanding liability.

   b. David Fried- CGA: There is no authority for the Commission to restrict legal efforts by cardrooms to collect on dishonored checks. Cardrooms should be able to accept a personal check that is meant to clear a bad check. Further, cardrooms should be allowed to enter into an installment payment agreement with a patron that is short of funds. In this case, the patron would pay down the debt by writing monthly payment checks to replace the bounced check.

   Response (a. & b. above): These comments were rejected. In response to the first issue, Section 12388(f) already allows patrons to replace a personal check that was written to the cardroom at the beginning of play, with another personal check, as long as the original check has not yet been deposited by the cardroom and three banking days have not elapsed. In response to the second issue, this section does not prohibit a cardroom from allowing patrons to replace a dishonored check with another personal check, or multiple personal checks. The only condition to either of these scenarios is that the *replacement* check(s) cannot *again* be replaced later with another personal check. This condition was introduced during the first 15-day change so that a cardroom cannot allow a patron to replace one check with another, over and over again, in an effort to avoid having the overall transaction considered as an extension of credit. Some local jurisdictions do not allow cardrooms to extend credit.

C. Comments Made Outside the Public Comment Periods

The following written comments were received after the close of the first 15-day change public comment period. Although these comments are included in the file without a response, they are generally reiterations of comments made during the first 15-day change public comment period. As a result, responses have already been provided.

1. William Zender – Last Resort Consulting: Extending credit to "house prop players" to use in poker games does not give the house an interest in the game, it does not affect the strategy or odds of the game for other players, and it does not intimidate other players. "House prop players" are used to keep the game going when a table drops to six or less players.

2. David Fried- CGA: Cardrooms should be allowed to resolve bad checks through installment payments, even if one of the installment payment checks later bounces. We would like the administrative record clarified to reflect that the Commission does not intend to hinder installment payment plans where the patron has made payments on the balance.

   The laws cited in the response to our August 17th comment about prohibiting credit to house prop players are applicable only to a licensed TPPS, not an employee of the cardroom (i.e. house prop player). Further, there is no banking in poker games because all players wager into a common pool rather than against a single participant.