Improving Gaming Regulation:
10 Recommendations for Streamlining Processes While Maintaining Integrity

By David O. Stewart, Ropes & Gray, LLP

Effective regulation is a cornerstone of the commercial gaming industry. It assures customers that the games are fair and assures communities that casino managers and owners are trustworthy. Because regulation is central to modern gaming, it should be reviewed and updated regularly. Regulation needs to evolve as advancing technology transforms the industry, changing both the games to be regulated and the tools available to regulators. In addition, changes in the marketplace — for example, the conversion of many casino companies to publicly-held companies that are subject to parallel regulation[1] — may warrant reconsideration of previous regulatory requirements. Because of such shifts, regulatory practices that made good sense when first adopted can become outdated. A regulation that no longer serves its initial purpose, or has become duplicative, has sharply negative effects. By increasing costs, it diverts industry resources away from investment and innovations that create jobs and economic opportunity. It saps the creative spirit of employees. It wastes taxpayer dollars and industry resources on misguided enforcement. And it reduces the morale of regulators, who recognize that they are imposing standards that are losing their relevance.

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The goal of this report is not to reduce the regulation of commercial casinos, but to improve it. We are fortunate that many policymakers in commercial casino jurisdictions share this goal. Earlier this year, New Jersey adopted a sweeping consolidation and reform of its regulatory structure, eliminating much overlap and duplication.[2] Nevada also has embraced significant reforms, such as the private testing and certification of electronic gaming machines. We applaud these steps and hope to add to the momentum behind this critical movement.

In this report, we identify reforms that would free both regulators and licensees from processes that no longer serve their initial goals. In some instances, the proposed reform will require a statutory amendment. In others, a revised regulation will suffice. And in some, only a change in practice is needed. This report does not detail the specific action required in each jurisdiction; rather, it analyzes the regulatory problem and identifies an effective solution. The precise method for implementing that solution will be addressed by AGA members in follow-up exchanges with state policymakers.

This report is a collaborative effort reflecting the experiences of many employees of AGA members, including many who are former regulators, as well as conversations with current regulators. We have not, however, produced an exhaustive list of possible improvements in gaming regulation. Indeed, we hope this report will contribute toward a comprehensive consideration of ways to make gaming regulation work better.

We feature 10 reforms to improve gaming regulation. The first two address the licensing process, recommending that the terms of gaming licenses be lengthened to at least five years and that every licensing jurisdiction accept a uniform license application for both individuals and business entities. To improve the ability of gaming licensees to gain access to financing, the report proposes that institutional investors be exempted from licensing requirements unless they own more than 25 percent of a licensee, and that state regulators grant "shelf approvals" for transactions that licensees can conclude when future market conditions are favorable. The report also concludes that gaming licenses should not be required for most outside directors of licensees, while proposing improvements to licensing practices and urging the elimination of prescribed Minimum Internal Control Standards (MICS). Finally, the report makes two recommendations to reform regulation of gaming machines: to drop requirements for pre-notification when machines are shipped, and to stop requiring pre-approval of purely esthetic modifications to the art and sound displays on installed machines.

Recommendation #1: License Terms Should Be Indeterminate, or Extend for at Least Five Years

The length of casino licenses varies widely. Indiana and Michigan require annual renewals with a reinvestigation every three years, Missouri and Mississippi issue renewals every other year, and Pennsylvania grants three-year licenses. Illinois licensees face renewal every four years, while Louisiana licensees have five years between renewals. New Jersey and Nevada have abandoned license reinvestigations and renewals altogether.[3]

The indeterminate terms in Nevada, and more recently adopted in New Jersey, are based on a powerful rationale. The resources devoted to the licensing process are extensive, both for the license applicant and the licensing body. Highly detailed financial and personal information must be gathered, checked, assembled and submitted in a prescribed format. Interviews and background investigations of individuals must be performed. Based on a survey of 22 states that license commercial gaming establishments, in 2010 state regulators performed more than 900 license renewals for gaming operators and suppliers of gaming equipment and related goods and services. This tremendous effort and expense, which is really an industry unto itself, serves little regulatory purpose.

Once a casino licensee is in operation, it conducts business under close regulatory scrutiny. Regulators carefully monitor its financial results and

tax payments; they also review its auditing practices and results regularly; all changes in management must be reported and can be challenged by regulators, who also monitor surveillance and security activities; and every adverse incident on the gaming floor or anywhere else in the operation is subject to investigation by state law enforcement personnel. Moreover, every casino licensee has an ongoing obligation to maintain its suitability for licensing.[4] If a sound reason emerges to revoke a license, the responsible regulatory body will not wait until the end of a license term to do so. Rather, it can act promptly against the licensee. That is the principal reason why non-renewals have been very rare events throughout the history of legalized gambling.

Requiring a full relicensing after a predetermined term — be that term one year, or two years, or even five years — ignores these realities and condemns regulators and licensees to an empty exercise that squanders the resources of both. Gaming licenses should not have specific terms; alternatively, they should extend for at least five years.

Recommendation #2: Extend the Use of Uniform License Applications

Roughly a decade ago, the International Association of Gaming Regulators (IAGR), in coordination with the International Association of Gaming Advisors (IAGA), developed a model application form for key licensees (individuals in responsible positions) which has become the standard for the industry. The "Multi-Jurisdictional Personal History Disclosure Form" is used by key licensees who must file for licenses in multiple jurisdictions.[5] Although many jurisdictions have created "riders" to that form, in order to gather additional information, the standardized IAGR form substantially reduces the burden of the application process in those jurisdictions that accept it.

A brief review of the IAGR model demonstrates its value. It contains 76 separate data fields, which include 15 different schedules for information, such as (i) all residences occupied for the preceding 15 years, (ii) residences and occupations of all siblings and their spouses, (iii) detailed information on employment for preceding 20 years, and (iv) all loans taken out in excess of $25,000 by the applicant, his or her spouse, and dependent children. Although the completion of the IAGR form still requires hours of effort, that effort would be multiplied many times if each jurisdiction were to use its own unique form. Even minor variations in the format or substance of such data requests greatly complicates the license application process, particularly for individuals who must apply for key licensee approval in many or all of the 22 U.S. commercial gaming jurisdictions.

Yet a significant number of commercial gambling states — Illinois, Colorado, Indiana, Missouri, and Michigan — have not adopted this uniform application form. We strongly endorse its widest possible

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acceptance. As many jurisdictions have done, a state can create its own "rider," if necessary, which requests additional information while still granting applicants the benefit of the standardized format for the bulk of the application. By adapting the IAGR form, a state can significantly reduce the cost of doing business there, an advantage to all of its licensees.

In addition, a similarly uniform application form is needed for business entities that are licensed in multiple jurisdictions. Although IAGR has recognized the need for such a uniform application, it has not yet produced that document.[6] By swiftly developing that uniform application, U.S. gaming regulators could control their licensees' costs without reducing the effectiveness of regulation. We urge a renewed commitment to developing a uniform licensing application for business entities. A further priority should be the development of a standard short-form application for those license renewals requiring reinvestigation of the applicant. Alternatively, regulators should explore granting reciprocity when a license applicant is already licensed by a recognized gaming jurisdiction, avoiding duplicative background investigations for individuals and entities already have been approved by reputable authorities. A reciprocity policy could be implemented through an abridged license application form, which also was standardized for multiple jurisdictions.

Recommendation #3: Allow Waiver from Licensing or Registration Requirements for Those Institutional Investors Holding Less Than a 25 Percent Ownership of a Licensee

Suitability-based licensing of those who own gaming businesses is central to modern gaming regulation. But as gaming businesses have grown in size and scope, and increasingly are public companies, the character of their ownership has changed. Contemporary gaming companies may be owned in substantial part by institutional investors such as investment companies, pension plans, hedge funds, and other large financial institutions. Many regulators have noted that most such owners are passive investors; they ordinarily do not wish to manage the business and will do so only in unusual circumstances, such as when the business is undergoing reorganization.

Accordingly, many states allow the waiver of licensing and other regulatory requirements for institutional investors who own a non-controlling interest in the gaming business. In New Jersey and Nevada, that exemption can apply to institutional investors holding less than a one-fourth interest in a licensee.[7] In Mississippi and Indiana, a ceiling of 15 percent applies to institutional investors seeking regulatory exemption.[8] In Missouri, the executive director can grant an exemption for institutional investors owning up 10 percent of a licensee, while the full gaming commission has the power to grant such exemptions for ownership of up to 20 percent.[9]

Other states apply even more restrictive standards. In Illinois, institutional investors must register with the gaming board upon acquiring more than a 10 percent interest in a licensee; in Michigan a waiver may be requested for ownership of up to 15 percent.[10] In Pennsylvania, an institutional investor can file an Institutional Investor Notice of Ownership Form in lieu of licensure if it owns between 5 and 15 percent of an affiliate of an equipment manufacturer, or between 5 and 10 percent of a licensee operating a gaming facility.[11]

State regulations should allow automatic waivers of licensing and registration requirements for institutional investors — including SEC-registered investment advisers — holding up to a 15 percent interest in licensees, and permissive waivers for those holding up to a 25 percent interest in licensees. The higher threshold — already largely in place in New Jersey and Nevada — increases the number of potential purchasers for shares in gaming licensees and thereby permits significantly greater financing flexibility. Of course, gaming regulators should always retain discretion to deny waivers when specific circumstances warrant closer regulatory scrutiny. In most instances, though, the presence of institutional investors raises little regulatory concern. By facilitating the participation of institutional investors in the commercial gaming industry, regulators can improve licensees' access to the capital markets.

Recommendation #4: Extend the Use of "Shelf Approvals" for Debt Transactions and Public Offerings

Three states have adopted the use of "shelf approvals" for debt transactions of casino licensees. In Nevada, Mississippi, and Louisiana, regulators review and approve a proposed borrowing by a licensee in advance, thus avoiding the sometimes frantic application and review process for a proposed loan. With a shelf approval in hand, the licensee can conclude the debt transaction at any point over the next three years.[12] The advantage to the licensee is substantial, allowing it to wait for the best credit opportunity in the capital markets. When the markets turn favorable to borrowers, the licensee with a shelf approval can strike quickly. Without a shelf approval, the licensee can miss the best market opportunities while waiting for regulatory action. Shelf approvals thus give casino licensees the flexibility that most businesses enjoy to respond to changing market conditions. As a safeguard, shelf approvals can include conditions on the structure of the transaction that may be prudent to protect a licensee's solvency. In that fashion, shelf approvals can be granted without compromising regulatory responsibility.

Legislators and regulators should authorize shelf approvals that would remain in effect for up to five years, and should also be available for public offerings of securities after a company's initial public offering.

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Recommendation #5: Require No More Than Registration of Outside Directors

Recruiting outside directors is a constant challenge for licensed gaming companies. Outside directors with strong backgrounds in fields like finance, marketing, and information technology can make powerful contributions to a licensee's management and growth. Yet most potential outside directors have never been licensed in the casino industry. When such individuals confront the mandatory licensing process in all its scope and complexity,[13] they often decline directorships with gaming companies; they cannot justify undergoing the intrusive background check and suitability investigation for a very part-time responsibility. This phenomenon shrinks the pool of talented individuals available to serve this important function for gaming licensees.

Instead of a blanket licensing requirement, regulators should impose that requirement only when warranted for a specific outside director. For the majority of outside directors, gaming regulators should require only basic employment and identification information. Even that level of oversight does not seem necessary, considering that all directors of private and public companies are bound by core fiduciary responsibilities to serve the company's interests; they face substantial personal liability if they fail to meet those responsibilities. This shift from licensing to no more than registration of most outside directors would substantially widen the field of individuals who would serve in that position with gaming licensees, which would strengthen their managements.

Recommendation #6: Eliminate Unnecessary Regulatory Filings

In different U.S. jurisdictions, licensees must file certain quarterly and annual reports that no longer serve a material regulatory purpose. In some instances, the information in the reports — generally about the ownership, management, and finances of the licensee — are otherwise available to regulators online or through other licensee submissions. Yet even when a report calls only for such routine information, the licensee must prepare it with care and verify its accuracy; gaming regulation imposes stiff penalties for errors in any official report. If each licensee in a state must file five unnecessary reports of a single type every year (four quarterlies and one annual), the overall compliance costs in that state mount quickly. Strikingly, only a few states require any of the periodic reports that we nominate for elimination. That so many gaming regulators find these reports unnecessary is powerful evidence that they are expendable.

a. **Foreign gaming reports** — Nevada and Mississippi subject their licensees to a supplementary level of regulatory review when they acquire gaming licenses in other jurisdictions.[14] Only Nevada requires that its licensees with "foreign" (non-Nevada)

licenses file quarterly and annual reports of their foreign activities. For each foreign gaming license, those reports must specify:

- Changes in ownership and control;
- Changes in officers, directors, or key employees earning $125,000 or more;
- All gaming complaints, disputes, and disciplinary actions;
- All employee arrests related to gaming;
- All arrests and convictions for gross misdemeanors or greater offenses of any officer, director, key employee or equity owner earning $125,000 or more.

The annual foreign gaming report requires, in addition, information about the licensee's compliance with accounting, internal control, and audit procedures in foreign jurisdictions, as well as surveillance requirements. These ordinarily involve detailing any regulatory changes or enforcement actions brought in the other jurisdictions.

Yet for Nevada licensees owned by a public company, all of this information is available to gaming regulators through other means. For many years, Nevada has imposed a compliance plan requirement on public companies that own or control Nevada casino licensees. Under that requirement, the licensee must establish a compliance committee that reviews every adverse incident and regulatory development that must be included in the foreign gaming reports. The minutes of the compliance committee meetings are submitted directly to the Nevada Gaming Control Board. Consequently, the compliance committee provides regulators with the same information they are receiving through the foreign gaming reports; indeed, the compliance materials often will be submitted before the foreign gaming report is due, and will be more extensive.[15]

Twenty-one commercial gaming jurisdictions do not require foreign gaming reports. Neither should Nevada. By retaining that regulatory requirement for the 18 public companies that operated 68 casinos, it compels the industry to produce nearly 100 unnecessary reports each year.[16]

b. Loan Reports – Only Mississippi and Nevada require their licensees to report loan transactions, as well as any revisions and amendments to existing credit arrangements.[17] When the licensee is owned or controlled by a publicly-traded company, however, those reports are duplicative. Public companies report all such

information on a quarterly basis to the U.S. Securities Exchange Commission (SEC), which posts those reports (Forms 8-K and 10-K) online, making them freely available to gaming regulators. Moreover, 20 state licensing jurisdictions do not require loan reports for publicly-traded companies. There is no reason for Mississippi and Nevada to do so.

c. **Ownership Reports** – Three states — Illinois, Indiana, and Louisiana — require quarterly filings by licensees detailing their ownership structure. The required information includes a listing of (i) significant shareholders and (ii) their percentage of ownership of the licensee: Illinois requires the listing of all who hold more than 5 percent, while Indiana and Louisiana require listing of all who hold more than 1 percent. The quarterly ownership reports also must detail the licensee's officers and directors.

   The information required in the quarterly ownership reports is otherwise readily available to regulators. Officers of a licensee, for example, must be licensed as "key employees," so regulators are fully informed about their personal histories. Corporate directors, also, are reviewed and approved by gaming regulators. (We contend above that licensing need not apply to outside directors, see pp. 7-8, *supra*.) Indeed, licensees are always under an obligation to notify gaming regulators of changes in their roster of officers or directors, or when significant ownership positions are established or transferred. For example, a licensee in Indiana and Louisiana has a blanket duty to advise the gaming commission of "any material changes in the information" in its license application, while the transfer of ownership interests is subject to separate regulatory review. In Illinois, licensees must maintain a current table of ownership and control and provide updates to the gaming commission.[18] Publicly-held licensees provide such information in quarterly SEC filings.

   Gaming regulators in 19 other states have found no need to require quarterly ownership reports. With approximately 40 casino licensees in Illinois, Indiana, and Louisiana, plus numerous suppliers of gaming equipment also licensed in those states, the industry files hundreds of ownership reports a year in those jurisdictions; none of those reports provides material assistance to gaming regulation. They should be eliminated.

d. **Quarterly Contract Reports** – A few jurisdictions require that their licensees file periodic reports of certain contracts, along

with copies of those contracts. A Michigan regulation requires reporting of all written contracts that exceed $250,000 per year, and all verbal contracts that exceed $25,000 annually.[19] In Indiana, casino licensees must submit a quarterly report listing all written contracts valued at more than $50,000 for a 12-month period, or more than $25,000 for a verbal contract. Each quarterly report also must specify (i) the terms of the contract, (ii) the nature of the goods or services involved, and (iii) how fair market value was determined for the contract. The executive director of the Indiana Gaming Commission has discretion to waive these requirements.[20] In Illinois, licensees must submit quarterly and annual reports of all "related party" contracts in excess of $50,000; "related party" is defined to include all businesses that are not publicly held, or businesses associated with relatives of licensed key casino personnel. A similar requirement in Missouri applies a much higher reporting threshold of $500,000.[21]

These reports serve no practical regulatory purpose. The original reason for them was to protect casino licensees from the influence of undesirable suppliers and contractors. But with the development of internal compliance committees for licensees, suppliers and contractors are subjected to due diligence review by the licensees; records of those reviews are maintained by the licensee's compliance committee and are available to regulators for their review; indeed, those records are ordinarily far more informative than the regulatory reports. Because this reporting requirement imposes a heavy compliance burden without conferring a corresponding regulatory advantage, most commercial casino jurisdictions do not require them. That course should be followed everywhere.

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Recommendation #7: Update Licensing Procedures and Practices

A few simple revisions of current licensing practices would substantially reduce the expense and burden they create for regulators and license applicants. These include:

- When reviewing an individual's license application, the regulatory employee may seek a report on that person's credit standing, but the regulatory employee should be careful to specify that the request is "employment-related" and not "credit-related." When an individual is subject to repeated credit-related requests for credit checks, the requests themselves result in a reduction in that person's credit rating, damaging that person's

ability to borrow. In contrast, requests for an employment-related credit check do not have that negative effect but still allow the gaming regulator to evaluate the licensee's suitability. If regulators in several jurisdictions ask for credit checks without specifying that they are employment-related, casino employees who are licensed in multiple jurisdictions may see their credit ratings unnecessarily diminished. No one should suffer a loss of credit rating simply because his or her job requires a state gaming license.

- The process of submitting fingerprint images can be time-consuming and burdensome for the casino license applicant who has to visit a law-enforcement agency on each occasion when fingerprints are taken. Indeed, some jurisdictions require that fingerprints be taken by a law enforcement agency within that jurisdiction, which is a further inconvenience particularly for those employees licensed in multiple jurisdictions and subject to continuing license renewal. Regulators should accept certified electronic images of an applicant's fingerprints that were previously taken by a legitimate law enforcement agency without requiring that new fingerprints be taken.
- The practice of conducting regulatory interviews of license applicants also can be managed better to control cost and effort. Particularly when an executive or manager is located in a distant location — even overseas — a license applicant or regulatory officials may face lengthy and expensive travel for a relatively brief interview; the casino licensee ordinarily must foot the bill for that travel. Happily, technology provides a cost-effective alternative. Video-conferencing should be utilized in most such cases. Moreover, when only a license renewal is involved, and the individual previously has been interviewed by regulators, the interview requirement itself is unnecessary and should be dropped.
- Some states, including Michigan and Pennsylvania, require the licensing or registration of nongaming employees and managers, such as those involved in hotel administration, food and beverage, or entertainment.[22] These licensing requirements serve no gaming regulatory purpose and also should be eliminated. Non-gaming employees, by definition, play no role in the design or delivery of gambling services to consumers. They are in no position to influence the conduct of gaming at a casino premises, nor are they involved in accounting, surveillance, or security services. The responsibilities of those non-gaming employees are no different from those of workers at nearby motels, restaurants, or performance halls, and there is no public policy reason to

require licensing of either group of workers. Regulators may reasonably require a simple notice that non-gaming employees have been hired — a listing of name, address, and job - but no further requirements should be imposed.

- State regulators should allow the secure electronic filing of periodic reports and other submissions by licensees. This course is followed by the SEC for corporate reports, and by the Financial Crimes Enforcement Network of the U.S. Department of the Treasury for its anti-money laundering reports. Electronic filing would reduce paper-handling and storage costs for both licensees and regulators.
- Most gaming jurisdictions treat all information in a gaming license application as presumptively confidential. In Indiana, however, a license applicant is supposed to identify every element of an application that is confidential, recite the element of Indiana law that establishes its confidential status, and request that confidential treatment be extended to that provision.[23] This burdensome process serves no public interest and risks the inadvertent public disclosure of much confidential information. Indiana law should follow the policy of other gaming states in affording confidential treatment to all license applications.

Recommendation #8: Eliminate Prescribed Minimum Internal Control Standards (MICS)

Illinois and Missouri require that casino licensees establish and comply with a system of "minimum internal control standards" (MICS).[24] These exhaustive documents, which routinely run to several hundred pages, represent an unnecessary level of regulatory micro-management. By freezing casino listings of positions, job descriptions, and organizational structures, MICS create bureaucratic paralysis. Examples of confounding MICS are easy to find:

- Missouri specifies that casino chips "shall be maintained in trays, which are covered with a transparent locking lid when the tables are closed. The information on the Table Inventory Slip [listing the chips in use at a gaming table] shall be placed inside the transparent locking lid and shall be visible from the outside of the cover. In case of an emergency (i.e., power outage, medical emergency at the table, etc.), the transparent lid will be locked over the inventory until normal play resumes."[25]
- Also in Missouri, "The main bank cashier shall run an adding machine tape on the Fill Slips and verify the total to the amount in the automated accounting system. All fill paperwork will be forwarded to Accounting."[26]

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- Illinois details very specific procedures for licensees who allow the collection of employee tips in "tip boxes" on the gaming floor:

  "1. Tip boxes may be emptied into locked holding containers located within the pit area. This function must be performed by at least two employees, of which one must be a dealer. Surveillance must be notified prior to emptying the tip boxes.

  "2. The drop and count of tip boxes and holding containers must be performed following closure of all table games or closure of the casino by one or more randomly selected dealer(s) and a non-gaming employee who is independent of the verification process and subsequent accountability of the tip count proceeds. The drop and count of tip boxes and holding containers must not be performed simultaneously or conflict with any other tips and gratuities drop and count. Include the location of the count of the tips.

  "3. The results of the tip count must be recorded on at least a two-part gratuity deposit form and signed by the tip count team prior to verification by a casino cage cashier.

  "4. The tip drop must be transferred to the casino cage by the casino cage cashier who verified the tip count and security, if verification of the count is performed at a gaming table. If verification of the count is performed at the casino cage, the tip drop must be transported to the casino cage by the tip count team.

  "5. A casino cage cashier must, in the presence of the tip count team, verify the tip count, without prior knowledge of the results of the tip count team's recorded count, sign the gratuity deposit form, retain one part for accountability and return a signed copy to the tip count team."[27]

We reproduce these requirements not because they are foolish or wrongheaded in themselves. In each instance, they represent a considered approach to management issues that predictably arise in the operation of a casino. But however logical each individual MIC standard may be, the entire enterprise of promulgating and enforcing MICS is fundamentally flawed and should be abandoned. Indeed, these examples reflect how such requirements become technologically obsolete. "Adding machine tapes" have been replaced with electronic financial records in the present-day casino.

Most important, the MICS requirements apply a one-size-fits-all brand of management to complex business organizations, and thereby fail to

account for unique situations that apply at individual casino properties and in specific management structures that have their own histories and personnel. Similarly, they rigidify casino procedures and make it substantially more difficult to integrate new technology and management improvements.

What if a Missouri licensee wishes to have the accounting records of fill slips maintained electronically, rather than on an "adding machine tape"? Or what if an Illinois licensee would like to have tip boxes emptied and accounted for by the same people who empty the hoppers of electronic gaming machines, and to do so at the same time they are handling the electronic gaming machine hoppers? None of these relatively modest innovations would be permitted under the relevant state MICS.

Yet it is no small matter to secure a revision in state MICS. In Illinois, for example, there are six different categories of changes to internal controls: Substantive, Administrative, Deviation, Emergency, New Game, and "Internal/External Audit Finding/Recommendation." Only Emergency and New Game changes may be submitted at any time; other types of changes may be proposed only quarterly, in duplicate, in redlined format. The review and approval process for such changes, set forth in its entirety in the footnote below, can only be described as excruciating. Indeed, once a licensee submits a proposed revision to its internal control standards, it cannot withdraw the proposed change without the written permission of the Deputy Director of the Illinois Gaming Board.[28]

The net result of these elaborate processes is unfortunate. Operations become ossified. New technology and new ways of organizing the business are disfavored. The cost of change is simply too high. Moreover, it cannot be argued credibly that MICS are essential, that commercial casinos are more law-abiding or better run in Illinois and Missouri than they are in the many states that have wisely chosen not to impose MICS.

For all of these reasons, most state policymakers have avoided the micro-management that attends the implementation of prescribed MICS. Instead, they allow licensees to develop their own operational procedures and organizational structures. If an incident or pattern of incidents suggests that licensees have neglected an important concern, regulators require that they address the situation. Indeed, New Jersey's recent reform of its regulatory processes included a fundamental transformation of its approach to internal control standards. Now, New Jersey licensees create internal controls and file them with their regulators, but those standards are not subject to regulatory approval.[29] As explained in the preamble to that legislation, New Jersey amended its statute "to allow licensees to take full and timely advantage of advancements in technology, particularly in information technology, and business management."[30] To achieve the same purposes, Illinois and Missouri should rescind their MICS requirements.

With more than 800,000 electronic gaming machines in operation across the country, many being moved from one location to another, manufacturers file blizzards of shipment notifications. In fiscal year 2011, a single large manufacturer had to file more than 5,000 shipping notifications.

Recommendation #9: Eliminate Prior-Notice or Pre-Approval of the Shipment of Electronic Gaming Machines

A number of casino jurisdictions require that manufacturers of electronic gaming machines give prior written notice to regulators that they will be shipping or moving machines into, out of, or within that state. These requirements vary in different jurisdictions. Maryland insists on 14 days notice; Indiana requires 10 days; Missouri and Mississippi demand 5 days.[31] Some jurisdictions require written regulatory approval before certain shipments can be made.[32] There is little reason for these taxing requirements.

The prior-notice and pre-approval procedures create considerable confusion for licensees. First, different states require notice within different time periods, complicating the task of coordinating machine shipments. Licensees must not only arrange the logistics of moving equipment in a cost-effective manner, but also must track the time periods that have elapsed since notice was provided to each relevant regulator. For example, a shipment out of Missouri requires only five days notice, but if the machine is going to Indiana, the destination state must have 10 days notice. Penalties are quickly assessed on any manufacturer who inadvertently delivers a machine before the notice period has expired.

The result is to increase the costs for licensees. With more than 800,000 electronic gaming machines in operation across the country, many being moved from one location to another, manufacturers file blizzards of shipment notifications. In fiscal year 2011, a single large manufacturer had to file more than 5,000 shipping notifications. Projected across the entire industry, tens of thousands of these notifications are filed every year.[33]

Yet prior-notice and pre-approval requirements for machine shipments contribute nothing to the goals of gaming regulation. Under current practices, regulators who receive shipment notices take no action in response to them; those regulators issuing pre-approvals have little basis for denying the request for approval. Because these requirements have become empty formalities, Nevada requires notifications only for shipments out of the state; yet there is no justification even for that requirement.

Regulators may have a legitimate interest in knowing what machines are installed at licensed gaming facilities in the state. That concern can be amply served by a post-delivery notice that a machine has been installed. Indeed, that concern would equally be served if the manufacturer and the casino operator simply maintained logs recording which machines have been delivered, so long as regulators had access to those logs.

Recommendation #10: Reduce the Number of Pre-Approvals for Electronic Gaming Machines

State regulators impose extensive requirements on electronic gaming machines. Some prescribe physical standards for patron safety. Others control the mathematically-derived payout tables for the machines. Still others ensure the accuracy of the game descriptions and disclosures on the face of each machine. Every electronic gaming machine is subjected to testing on all of these criteria, by either public or private laboratories that certify a game's compliance with applicable standards. In most jurisdictions, the "technical standards" for such machines run to dozens of pages.[34] In addition, regulatory pre-approval is required for every modification of a machine. Due both to the complexity of the machines and the need to introduce innovations to freshen their appeal to consumers, modifications account for a large majority of these machine approvals. The volume of pre-approvals is staggering. In a single year, one manufacturer submitted more than 18,000 requests for pre-approvals.

Over the long term, this burden can be controlled if the pre-approval process evolves into one where manufacturers can certify compliance with at least some of the regulatory requirements, which would also be subject to random regulatory confirmation. Under such an approach, regulators would always apply core regulatory standards before a gaming machine could operate; these core standards would include the operation of the random number generator, the mathematical payouts in the game, and the disclosures and game descriptions provided to customers.

Other elements of gaming machines — specifically, the many modifications required for gaming machines already in operation — may reasonably be handled by a system of manufacturer certifications. This approach should work well for many minor security or technical upgrades to an electronic gaming machine. Today, however, we suggest an even more modest first step down this road: to allow manufacturers to certify a machine's compliance, without a regulatory pre-approval, for purely esthetic changes to a machine — that is, for changes that relate only to the art displays on a machine or the sound components that may be heard while the machine is played. The manufacturer could change either the art displayed or the sound components so long as it filed a certification with the relevant regulatory authority that described the modification and certified its compliance with applicable regulations. The regulators would be able to spot-check those certifications.

We endorse this certification model for esthetic modifications because those changes implicate so little regulatory concern. They make no difference to the fairness of the games, the reliability of the machines, or the customers' understanding of their playing options. Yet moving to a certification approach for esthetic modifications could reduce regulatory

A healthy, vibrant gaming industry requires a healthy, technologically savvy regulatory sector. Because gaming regulation is so extensive and costly, it is essential that it be evaluated constantly to ensure that it is not deadening initiative or loading unnecessary costs on the industry.

and compliance expenses substantially. Our best estimate, based on the experiences of several major manufacturers, is that purely esthetic modifications account for roughly one-fourth of the regulatory pre-approvals per year. In addition, the certification approach would allow manufacturers to implement modifications more quickly in order to take advantage of marketing opportunities — say, if a particular song or entertainment image has become very popular.

Conclusion

A healthy, vibrant gaming industry requires a healthy, technologically savvy regulatory sector. Because gaming regulation is so extensive and costly, it is essential that it be evaluated constantly to ensure that it is not deadening initiative or loading unnecessary costs on the industry, which must compete for customer dollars against a broad range of entertainment options (movies, live performances, restaurants, etc.) that face much less regulation.

We hope that this report will assist regulators and state policymakers in identifying regulatory improvements than can help the industry meet its technological and competitive challenges and make the investments that will create jobs and opportunity in the future. Those regulatory improvements also can save taxpayer dollars. Just like gaming companies, gaming regulation must continually reinvent itself to match changes in the economy and technology.

Endnotes

[1] In Nevada in 2010, for example, eighteen publicly-held corporations operated 68 casinos that generated 76.2 percent of all gaming revenue in that state. Nevada Gaming Abstract 2010, at 4-6.

[2] NJ Senate Bill No. 12 (Feb. 1, 2011) (hereinafter "S12").

[3] Ind. Admin. Code tit. 68 r. 2-1-9; Miss. Gaming Regs. § II-K-11(a); 11 Mo. Code Regs. tit. 11, § 45-4.190; 58 Pa. Code § 433a.9(a); Ill. Admin. Code, § 3000.237; La. Rev. Stat. § 27:74.

[4] La. Admin. Code tit. 42, § 2141.

[5] http://www.iagr.org/docs/Phd1a.pdf.

[6] Scott Scherer & Thomas N. Auriemma, Report of International Association of Gaming Regulators to Trustees of International Association of Gaming Attorneys (2004).

[7] New Jersey Casino Control Act,§ 5:12-85.1(g); Nev. Gaming Reg. § 16.430.1.

[8] Miss. Gaming Reg. § II-H-23; Ind. Admin. Code tit. 68, §§ 1-1-86, 2-1-4(g).

[9] Mo. Code Regs. tit. 11, § 45-4.020(2)(b)(1).

[10] Ill. Admin. Code tit. 86, § 3000.234; Mich. Admin. Code r. 432.1504(3).

[11] 58 Pa. Code § 433a.5.

[12] Nev. Gaming Reg. § 16.115; Miss. Gaming Reg. § II-H-7(b); La. Admin. Code tit. 42, § 2525.

[13] Nev. Gaming Reg. § 15-585.7-7; 58 Pa. Code § 433a.2; Miss. Gaming Reg. § II-G-4; La. Admin. Code tit. 42, §§ 2203, 2107(A)(2), 2109; Mo. Code Regs. tit. 11, § 45-4.020(3)(A).

[14] Nev. Rev. Stat. §§ 463.680-463.720; Miss. Gaming Reg. § II-L-3(h).

[15] The compliance committee process is by no means the only way in which regulators learn of such developments. Licensees often volunteer such information to their regulators, and the information also is frequently shared among regulators in different jurisdictions and reported widely in industry publications.

[16] By definition, foreign gaming reports must be filed only by those licensees with gaming operations in other states, so many of the more than 250 licensed casino operators in Nevada do not have to file them. Nevertheless, many do.

[17] Nev. Gaming Reg. § 8.130; Miss. Gaming Regs. § II-I-11.

[18] Ind. Admin. Code tit. 68 r. 2-1-10(b); id. at 2-1-5; 42 La. Admin. Code tit. 42, §§ 2151(B), 2521, et seq.; Ill. Admin. Code tit. 86, § 3000.223.

[19] Mich. Admin. Code r. 432.1220.

[20] Ind. Admin. Code tit. 68 r. 1-4-7, 1-4-11.

[21] Ill. Minimum Internal Control Standards, § N (related party transactions); Mo. Minimum Internal Control Standards, § O.

[22] 58 PA Code § 435a.5; Mich. Admin. Code r. 432.1332, et seq.

[23] Ind. Code § 4-33-5-1.5.

[24] Ill. Admin. Code, tit. 86, §§ 3000.320, et seq.; Mo. Admin. Code tit. 11, Chap. 9. When it struck down federal regulations establishing MICS for tribal casinos, an appellate court observed that those regulations consumed eighty pages in the Code of Federal Regulations, that "[n]o operational detail is overlooked," and recited with a sense of wonder the regulatory limits on the length of time when playing cards can be used, on the number of employees who must participate in removing coins from gaming machines, and how the coins may be transported. Colorado River Indian Tribes v. NIGC, 466 F.3d 134, 136 (D.C. Cir. 2006).

[25] Mo. MICS, ch. D, § 2.03.

[26] Id. § 7.09.

[27] Ill. MICS § O, at O-1 to O-2.

[28] "IGB Approval Procedures

> "1. Owner Licensees must designate to the Internal Control Unit Manager the individual responsible for ICS [Internal Control Standard] submissions, including the coordination of "verbal comment" meetings and re-submissions, if any.
>
> "2. Each ICS submission will be reviewed by the Internal Control Unit to determine that it is complete and that extensive comments are not necessary.
>
> "3. If the submission is determined to be incomplete or requires extensive comment, the Owner Licensee may revise the submission and resubmit it during the next quarterly submission period.
>
> "4. If the submission is complete and does not require extensive comment the Internal Control Unit will review the submission and determine compliance with the IGB Adopted Rules, Illinois Riverboat Gambling Act, the MICS and consistency with the ICS of the Owner Licensee.
>
> "5. The Internal Control Unit will respond to the submission with written and/or verbal comments. All correspondence must include a reference to the ICS Change Number.
>
> "6. Unless otherwise instructed by the IGB, an updated revision form must accompany all resubmissions, along with a complete set of redlined pages with an updated revision date on each page and an explanation of each change made in response to IGB comments.
>
> "7. Resubmissions must not include unrelated additional changes unless requested by the IGB.
>
> "8. When a change is approved, the Owner Licensee will receive an approval letter from the IGB Administrator. The effective date will be stated in the approval letter and stamped on each approved page. No change will be implemented prior to the effective date as set forth in the approval letter from the IGB Administrator.
>
> "9. If the effective date on an approval letter is "no sooner than the beginning of the gaming day", the Owner Licensee must notify the IGB in writing of the implementation date.
>
> "10. No ICS submission may be withdrawn without written approval of the IGB Deputy Administrator, Audit & Financial Analysis."

[29] S12, § 65, amending § 99 of the New Jersey Casino Control Act, N.J.S.A. 5:12-99.

[30] S12, § 1(b) (19), amending N.J.S.A. 5:12-1.

[31] Code of Md. Regs. §14.01.12.04; Ind. Admin. Code tit. 68, § 17-1-2; Mo. MICS § 6.01.

[32] Del. Video Lottery Regulations, §§ 10.1, 10.3.

[33] See also Remarks of Richard Haddrill, CEO Bally Techs., IAGA Conference, Washington, DC (Oct. 12, 2010).

[34] Nevada Gaming Control Board, Technical Standards for Gaming Devices and On-Line Slot Systems, http://gaming.nv.gov/stats_regs/reg14_tech_stnds.pdf.

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About the Author

David O. Stewart joined Ropes & Gray as a partner in 1989 to begin a litigation group in the Washington, D.C. office. His experience in complex litigation includes appellate and Supreme Court litigation, antitrust and commercial disputes, white-collar criminal defense work, health care law, gaming law and a variety of challenges to government regulation and enforcement.

David has served as principal counsel in federal jury trials, state court trials, administrative proceedings, numerous appeals, and the impeachment trial of Judge Walter L. Nixon, Jr. before the U.S. Senate. David argued before the Supreme Court in *Ludwig v. Variable Annuity Life Insurance,* 115 S. Ct. 810 (1995), concerning the power of national banks to sell annuities, and also argued for the petitioner in *United States v. Nixon,* 506 U.S. 224 (1993).

David lectures to professional groups on topics including antitrust, gaming law, health care law, money laundering, cable television litigation, and white-collar criminal issues.

AMERICAN GAMING ASSOCIATION

1299 Pennsylvania Avenue, NW
Suite 1175
Washington, DC 20004
202-552-2675
www.americangaming.org