

NEVADA'S NEW GAMING COMPLIANCE UNIT:

What Licensees Need to Know



By Dave Staley and Luke Rippee

The Nevada regulatory model places a high barrier to entry. Initial licensing investigations are expensive, time consuming, and very intrusive. However, after a company has met the stringent requirements for licensure, Nevada does not require annual or regular licensing renewals, which means the Nevada Gaming Control Board (“Board”) may not review company operations for several years until it files a new licensing application, often related to acquisitions, financing, or issuance of new equity securities.

As the Nevada gaming market expanded, the industry became more attractive to large publicly traded

corporations (“PTCs”), which had the resources and capital needed to compete in the growing market. In addition, legal gambling outside of Nevada began growing. The Board was concerned about its ability to regulate foreign companies involved in gaming within the state of Nevada and the activities of current Nevada licensees maintaining operations outside the state. As a result, the Board began to require PTCs that owned licensees and some privately-held licensees to institute gaming compliance plans (“Plan” or “Plans”) to ensure that they conducted business in a legal manner wherever they maintained operations and to ensure that they did not conduct business or

associate with individuals or entities that might bring disrepute or taint the image of the company, and, by extension, the gambling industry in the state of Nevada.

When and Why Did the Board Create a Specific Compliance Review Group?

The Board requires Plans to ensure that Nevada gaming licensees and, in most instances, the PTCs that own such Nevada gaming licensees, conduct their own due diligence and are invested in the process of maintaining their good reputation and the reputation of the Nevada gaming industry.

In the past, Plan reviews have been conducted in connection with ongoing licensing investigations or on a stand-alone basis. Active licensing applications have typically been viewed as more important than Plan reviews. Thus, Board agents have frequently been pulled off the Plan reviews to complete the licensing investigation, resulting in the compliance reviews stopping, restarting, and then stopping again. Some Plan reviews had field work conducted by one Board agent, analyzed by another, and the results then written up by yet a third agent, often over an extended period of time. This process proved to be ineffective for the Board and unhelpful to the licensees. As a result, the Board created the Compliance Unit, to which it dedicated Board staff to oversee all aspects of a Plan, from creation to review after its implementation.

the Compliance Officer and/or Committee members. The Compliance Unit has also developed into an industry-facing resource available to the licensees to help answer inquiries.

How Many Companies Currently Have Mandated Compliance Programs? Are Such Programs Limited to Public Companies?

At the time of this writing, there are approximately 53 Plans currently in place. Most are mandated in PTCs Orders of Registration, but some have been required for privately-held licensees pursuant to conditions on a specific license or terms of a Stipulated Settlement with the Nevada Gaming Commission (“Commission”) after disciplinary action. In addition, a few are required for Private Investment Companies (“PICs”), pursuant to NGC Regulation 15C.100(1)(e).

What are the Basic Provisions for Compliance Plans?

Some additional questions include: For those areas that dictate some level of due diligence by the company (i.e., vendors, consultants, material financing, material transactions, tenants, etc.), how does the GCB decide the appropriate monetary level to trigger a review by the company? Is there some formula used based on the size of the company and/or number of jurisdictions it conducts business in?



The Compliance Unit’s main task is to conduct Plan reviews, but the Compliance Unit also reviews Plans submitted by PTCs and privately-held licensees and offers suggestions or modifications to these Plans. The Compliance Unit is also assigned special projects and conducts annual meetings with

Pursuant to a PTC’s Order of Registration, it is required to establish and maintain a gaming compliance program for the purpose of, at a minimum, performing due diligence, determining the suitability of relationships with other entities and individuals, and reviewing and ensuring compliance by the entity and

its other subsidiaries or affiliated entities, with the Nevada Gaming Control Act (as amended), the Commission’s Regulations (as amended), and the laws and regulations of any other jurisdictions in which the company, its subsidiaries and its affiliates operate. A similar request has been placed on a number of privately-held licensees. Moreover, the Board requires companies that have Plans to fund a revolving account, which is used by the Compliance Unit to fund the conduct of its Compliance Plan reviews.



Plans typically include due diligence provisions in the following areas:

- Material Litigation
- Material Financing
- Material Transactions
- Key Employees/Officers
- Consultants
- Lobbyists
- Professional Advisors
- Junket Representatives or Independent Agents
- Vendors/Suppliers of Goods and Services
- Leases
- Tenants
- Loans
- Partnerships/Joint Ventures
- Political/Charitable Contributions

Manufacturers’ Plans can include, in addition:

- Distributors
- Purchases, Sales, and Leases of Gaming Equipment
- Current List of Legal Jurisdictions

The individual companies typically provide requested monetary thresholds when they submit their Plan. The Board will review the company’s purchasing or disbursement records and compare them to requested thresholds, as well as similar thresholds in Plans of similar-sized companies. The Board recognizes the burden that due diligence imposes on a company and tries to determine a reasonable monetary threshold based on historical financial records, the number of transactions exempt from due diligence reviews (*i.e.* “carve outs”), and the need for a company to complete due diligence on a significant but reasonable number of transactions.

With respect to carve outs, they traditionally fall into one of the following areas:

- Lawyers, CPAs, real estate brokers, banks, liquor licensees, etc. (unless being utilized as a lobbyist), who are reviewed merely to ensure they have a license and are in good standing.
- Gaming licensees are merely reviewed to ensure all licenses are active and in good standing.
- Public companies require only a cursory review to determine if any derogatory information exists

In *all* carve-out cases, if not mandated by the Plan, it is strongly suggested that the Compliance Committee (“Committee”) minutes reflect that an entity or individual triggered a review under the Plan and the Compliance Officer determined that a due diligence investigation was not required due to a Plan carve-out. It is always a safe practice to conduct a quick Internet, Google, or SEC filing search to ensure that no recent events might warrant additional review.



What is the Expectation on the Composition of the Compliance Committees?

Pursuant to a PTC's Order of Registration, or in the case of a privately-held licensee that is required to have a Plan, the Committee is required to have at least one independent member who is knowledgeable of the Nevada Gaming Control Act and Commission Regulations.

Some PTCs and licensees strictly follow Commission Reg. 5.045 and have only one independent member. Others have taken more of a Sarbanes-Oxley approach and have a Committee comprised of a majority of independent members. Then there's the third approach, where all members of the Committee are independent.

Independence is a key concept for successful Committee operation. As stated, the Committee serves as an advisory committee to company management and the company has selected its Committee members based on their integrity, as well as their knowledge of company operations and Nevada gaming regulations. The Committee is supposed to help keep the company from becoming involved in an unsuitable situation or association, but some decisions impact sales, projections, and individual bonuses. As a result, some management may be tempted to pursue commerce over compliance, with the result that an independent link between the Committee and the company's Board of Directors is crucial if management decides to act against the advice of the Committee.

Most companies have used independent members from its Boards of Directors as Committee members and some have ensured a linkage to the Board of Directors by reporting through its Audit Committee.

How Often Can a Licensee Expect to Undergo a Compliance Review or Audit?

Additionally, is such a review limited solely to the licensee's approved Plan (and related documents and

internal reporting procedures for the program)? If not, what else is examined?

On February 12, 2014, Board Chairman A.G. Burnett issued a Notice to Licensees indicating that the Board planned to begin conducting compliance reviews on a two- to three-year rotating basis. The Compliance Unit has adopted that review schedule going forward, but it looks like a three-year audit cycle is most likely.

During compliance reviews, Board agents spend considerable time ensuring they understand the process for transaction or data management that will trigger due diligence requirements as Plan thresholds are met.

In our experience, companies that have completed numerous mergers or acquisitions and are using different management information systems have a higher risk of missing required due diligence. Some



systems have difficulty integrating information and manual systems have a high potential for missing transactions that would require due diligence due to aggregation of multiple transactions across multiple operations.

Compliance Unit agents want to determine if the process works and if the Committee is well-informed when it makes its decisions. The Board has historically been far less concerned about a

questionable but well-informed decision made by a Committee, compared to a situation where a due diligence threshold was met but no due diligence was conducted and the relationship was never brought to the Committee's attention, even if there were absolutely no due diligence issues or concerns.

A Plan review is not limited solely to what is in the Plan. Companies grow and change through mergers and acquisitions, maturation, and diversification. For example, not all Plans include loans or tenants, so Board agents would look to see if these areas are a new business activity that is significant enough that it should be included in the future.

After numerous, high-profile anti-money laundering ("AML") issues with licensees, the Compliance Unit has begun requesting that AML language be inserted into Plans as they are submitted for other changes. The new language requires notification to the Board of any "non-routine" inquiry made by the Financial Crimes Enforcement Network ("FinCEN"). Non-routine inquiries would not include normal FinCEN or IRS audits or subpoenas for currency transaction reports ("CTRs") or suspicious activity reports ("SARs") relating to a specific customer, but only an unexpected request by FinCEN, the IRS, or others for information related to the company's compliance with AML requirements.

In addition, the Compliance Unit has begun reviewing applicable companies' Foreign Corrupt Practices Act ("FCPA") policies and procedures. While language addressing FCPA is not typically included in Plans, like AML language in the past, the Board is interested in better understanding its licensees' compliance with FCPA requirements.



What Does the Compliance Unit Look at During a Compliance Review or Audit?

Also, how long does such an audit take? How should the licensee prepare? Are there specific procedures for the audit (*i.e.*, a notice letter, an initial meeting with the licensee, a document request, interviews, closing conference, etc.)?

In addition to testing the areas covered under the Plan itself, the Compliance Plan review will compare problem areas identified during a past review, or examine any issues or concerns that have arisen since the last review. The examination of progress on issues identified during the last review helps determine the company's progress and commitment to compliance.

The Compliance Unit's first compliance reviews typically examine the last two full years of operations. After that, compliance reviews will pick up from where the last review period ended.

When starting a Compliance Plan review, the Compliance Unit contacts the company's Compliance Officer. Interviews are typically scheduled at the company's main office and records testing will be conducted at the main office and offsite as needed. Board agents typically review, but are not limited to, Committee minutes, compliance and finance records, SEC filings, Board of Director minutes, human resources records, and any other information needed to understand compliance processes or test Plan results.

After the fieldwork is completed, the Board agents complete a written report that summarizes the results of the Compliance Plan review. The report is sent to the three Board members for their review. After responses from the Board members are addressed, the Board agents conduct a closing conference with the company and then send a letter to the company summarizing the results. If necessary, the Compliance Unit thereafter works with the company to amend the



Plan to address any deficiencies noted in the compliance review. At this time, the company can propose any changes it has identified to improve its Plan. The Plan is the company's Plan and the process recognizes the need of the company to modify the Plan within the basic Board requirements. Each Plan should be molded to fit the unique size and needs of the licensee.

In closing, the Compliance Unit considers a licensee to have a strong compliance program that has the following key elements:

- Support of upper management
- Training and education for gaming staff and compliance department
- Confidential and secure record management
- Good working relationship with regulators in all jurisdictions



David Staley is a Special Agent with the Nevada Gaming Control Board's Investigation Division, Corporate Securities Section, Compliance Unit. He oversees the Compliance Unit which was created in July 2015. Special Agent Staley has 22 years of experience conducting corporate licensing investigations and compliance plan reviews for the Board. He has conducted licensing investigations and compliance reviews domestically and in England, Australia, Japan, Hong Kong, South Africa, Singapore, and Malaysia. Special Agent Staley attended the University of Nevada, Reno where he received both his undergraduate degree and Master's in Business Administration. Special Agent Staley recently completed the State of Nevada Certified Public Manager Program in 2017.



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