

## [WORKING DRAFT]

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### **Customer Account Protections, including protection of funds, data and privacy.**

#### **Introduction**

The protection of customer funds and data are fundamental to the integrity of remote gambling operations and the industry generally. The requirement for players to provide personal data at registration, for operators to continue to collect personal data (in particular data relating to gambling transaction history) and for players to deposit funds with operators in anticipation of their use in wagering transactions are all inherent in the remote sector. Customer funds and data are clearly of great value, both to the player and to others and therefore significant regulatory risks arise when they are supplied by players to operators for use in gambling. Issues of trust and security are therefore critical to a well-regulated industry.

Remote gambling is a form of e-commerce, a business sector which presents particular challenges with regard to consumer protection. “Distance selling” of goods and services generally involves the conclusion of contracts between a consumer and a supplier by remote means, where the two parties to the contract do not meet face to face, including via websites but also by other interactive means. By way of example, such contracts raise issues with regard to the sufficiency of information provided to the consumer regarding the goods or services offered at the time the contract is concluded, and questions regarding rights to return goods and to cancel contracts, including “cooling-off” periods.

Typically, remote gambling operators will be regulated in a jurisdiction which provides some form of distance selling protection to consumers such as, in the United Kingdom, the Consumer Protection (Distance Selling) Regulations 2000, which implemented European Union Directive 97/7/EC. Other European Union Member States were obliged also to implement the Directive and so have in place broadly similar measures. Whilst certain aspects of such regulations may not apply to gambling operations conducted remotely (such as the right to cancel under the UK regulations), such regulations are examples of the measures which apply generally in respect of consumer contracts concluded online.

Similarly, many aspects of data protection and privacy tend to be generic in any given jurisdiction and are not specific to gambling. For example, data protection laws tend to apply equally to, say, a clothing retailer as they do to an online gambling operator, and in most jurisdictions online gambling licensees are required to comply with prevailing data protection laws but not generally more<sup>1</sup>. However, due to the nature of remote gambling operations, and

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<sup>1</sup>Gibraltar Regulatory Authority Guidance Note 11/07;

Data Protection (Bailiwick of Guernsey) Law 2001 (re Alderney)

British Gambling Commission... - others?

the commercial value of customer data (and elsewhere), questions of data security are of particular importance. Not only is the industry highly competitive, but the extent and detail of personal information which must be retained by operators, including personal identification information and detailed transaction histories, means that breaches of data security in the online gambling sector are potentially more damaging than in many other sectors.

In simple terms, consumers of remote gambling services want to know that the data they submit in support of their account registration is kept secure. This is equally true of the data which accumulates as a result of their gambling (and which is required to be retained by a regulated operator in accordance with applicable record-keeping requirements, typically for a number of years), although one suspects that players are less aware of the depth and extent of this data, and of its inherent value (and therefore the risks involved in its retention).

Players are however generally aware of the risks involved in depositing funds with an online gambling operator, particularly so following recent events, including the problems with Full Tilt Poker. That in particular has focussed debate on the measures used by regulators to minimise the potential loss of customer funds in the hands of operators.

The general licensing principles which underpin the vast majority of remote gambling regulatory regimes promote the interests and the protection of the consumer and fairness and transparency in gambling, and are directed at minimising criminal involvement. All of these general principles are relevant to this topic, and in particular to the protection of the consumer.

However, the extent to which regulators prescribe particular mechanisms, or impose licence requirements on their licensees, to address these obvious regulatory risks can differ significantly.

### **Protection of Customer Funds**

There are often numerous inter-related elements of a online gambling regulatory regime which help to minimise the risk of loss of customer funds, including the effective scrutiny of licence applications to verify the fitness, propriety and financial standing of an applicant and those who own and/or work for that entity, and the effective audit and monitoring of operators through compliance, reporting and monitoring procedures. Such licensing and compliance considerations are fundamental to a successful regulatory regime and it is self-evident that a coherent and robust licensing system, including a detailed and rigorous assessment of licence applicants, and assiduous compliance and enforcement procedures will enhance the protection of customer funds and data. Indeed, as the former Chairman of the British Gambling Commission, Peter Dean has said:

*“Gambling regulators worldwide recognise that the best control is at the point of entry, and they take pains to ensure that no unsuitable applicant is granted a licence in the first place”.*<sup>2</sup>

Nevertheless, whilst this chapter does make occasional reference to such related regulatory measures, its aim is to concentrate analysis not on the broader indirect measures which collectively provide consumer protection, as these are covered elsewhere in this text. Rather,

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<sup>2</sup>“Full Tilt Poker Review”, a Report by Peter Dean to the Alderney Gambling Control Commission, 26 March 2012

this section will focus on those licence conditions and other mechanisms imposed by regulators to specifically address the manner and terms on which customer funds are held by a regulated online gambling operator, and to attempt to assess their relative suitability and effectiveness.

Of course, in any given jurisdiction these other indirect measures (such as scrutiny of licence applicants) provide the context within which the specific mechanisms directed at customer funds protection must operate, and are therefore relevant to their effectiveness, albeit indirectly. And these contextual factors vary considerably between jurisdictions, but it is not possible to take into account all such factors when undertaking the comparative analysis of the particular mechanisms used to protect customer funds. Instead, it is left to readers' broad understanding of the other factors, including from their reading of the other chapters in this text, to assist in this regard.

Factors which are also clearly relevant in this context include the size of the operator and the amount of funds it holds for players, the second aspect of which will be greatly influenced by the products that the operator offers.

Traditionally, the protection of customer funds in the gambling regulatory field has tended to focus on ensuring that the potential liability of operators in respect of pay-outs could be met. For example, a bookmaker would tend to face his greatest exposure if a series of heavily backed favourites were to win and, whilst a sensible bookmaker would price his odds accordingly, a regulator would typically require assurances that the bookmaker's risk management systems are robust and effective, and that he is in a financially secure position, meaning he can pay out irrespective of the outcome of those events on which he has offered markets.

Similarly, with bricks and mortar casinos, regulators typically require operators to hold a reserve reflecting their potential exposure to customer winnings, often on a worst case scenario basis. Having said that, it is interesting to note that, following consultation, in September 2011 the British Gambling Commission removed altogether the requirement for terrestrial casinos in the UK to maintain a gaming reserve, citing the disproportionate cost of maintaining a reserve when compared to the protection afforded to customers, which was adjudged to be minimal on the basis that evidence suggested there was only a small risk that any given reserve would ever be required to be called upon.<sup>3</sup>

In a physical environment, of course, operators tend not to retain customer funds in respect of future gambling, hence the focus on potential exposure to winnings. Similarly, in the online, or "remote" sphere, those betting on sporting or other events, and those playing casino games and slots online, do not typically deposit and leave large sums with the gambling operator for use in future gambling sessions, although there are of course always exceptions to this.

However, with the growth of community games such as online poker, regulators must now grapple with the issue of players' "stacks" being held by the operator, often on an ongoing basis, meaning that we now have a position where very significant sums of real money can be held on behalf of players by operators. Consolidation in the market, and the huge significance of liquidity in poker (and other P2P products), now means that there are a number of operators, especially in poker, which hold large amounts of customer funds, as highlighted by Full Tilt Poker, said to be owing several hundred millions of dollars to its customers.

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<sup>3</sup> British Gambling Commission, "Licence Conditions and Codes of Practice Supplement 9", September 2011

The question of securing customer funds is therefore no longer merely a question of covering potential exposure safely, but also of ensuring that potentially very large customer deposits are protected against possible misappropriation and insolvency.

There have been a number of high-profile examples in recent years involving the potential or actual loss of customer funds. In the case of the betting exchange Sporting Options in [2004], the operator is alleged to have used customer funds for its trading activities. In other words, it had reportedly used customer monies to meet its trading liabilities in order to continue to trade in circumstances where it may already have been insolvent, or might otherwise have become insolvent. In a more recent case of Worldspreads Limited, a spread betting subsidiary of Worldspreads plc, which was listed on the Alternative Investment Market in London and the Irish Stock Market ESM, ceased trading in March 2012 following the discovery by new management of “accounting irregularities”. It is reported that some £12 million was ‘missing’ from its client accounts.<sup>4</sup>

It is therefore increasingly important to consider the various mechanisms which are adopted by different regulators, often in combination, to seek to ensure that customer funds are protected and seek to draw conclusions as to those which are most effective and desirable.

However, the question arises as to whether player funds can be ever be fully protected. In his report to the AGCC following the regulatory proceedings which led to the suspension and revocation of the various licences held for the operation of Full Tilt Poker, Peter Dean said the following:

*“Gambling regulators differ in their attitudes on this topic, which range from caveat emptor at one extreme to favouring a complete safety-net at the other, though total protection is not achievable in practice.”<sup>5</sup>*

It is instructive at this stage to consider exactly why such an esteemed former regulator considers total protection of customer funds not to be achievable in practice.

So let us consider briefly the movement of funds in the first instance. At the moment a consumer instructs his bank to transfer monies from his own account to the account of an online gambling operator, or a payment-processing intermediary, he loses control of those funds. By definition, they are then at risk of misappropriation.

Indeed, even whilst a player’s money is within his own bank account, the player is not legally the owner of the funds; rather, the bank will have legal title to the monies and the player will be a creditor of the bank. In the financial crash of 2008, customers of the Northern Rock bank in the United Kingdom queued to withdraw funds from the bank in fear that its imminent collapse would leave them out of pocket and merely creditors seeking recovery in the anticipated insolvency of a bank. Similar “runs” on banks have occurred many times over history, and are symptomatic of the fact that customer deposits are legally held by a bank, which is a debtor of its customer. The funds are the assets of the bank, albeit with corresponding liabilities owed to customers, and they are at risk if a bank collapses.

Nevertheless, banking crises apart, once a player instructs his bank to transmit funds to an operator, those funds are generally exposed to a greater risk than they were when they were

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<sup>4</sup> Gambling Compliance “World’s End for WorldSpreads”, 19 March 2012

<sup>5</sup>“Full Tilt Poker Review”, paragraph 59

held in the player's own bank account. In broad terms, under the terms and conditions of a gambling website, the player will agree to transfer funds to be deposited within the customer account of the operator. Once the funds are actually transferred, the player will be a creditor of the operator. Whilst the funds are in transit the position will be governed by the applicable clearing house rules. To the extent that those funds may be in the bank account of a payment processor, it would be normal for the gambling operator (rather than the player) to be the creditor of the payment processor, because the direct contractual relationship will be between them, rather than between the processor and the customer.

Matters are further complicated by the use of credit card providers and the relationship between the card provider and the player, but such intricacies are not directly relevant to the present topic. Nevertheless, the player authorises the monies to be transferred to the operator and legal title to those monies will generally transfer from the player's bank (or card provider) to the operator's bank. At that point, once the funds have been received into the bank account nominated by the gambling operator, legal title will be held by the operator's bank. The gambling operator will be a creditor of the bank and the player will be a creditor of the operator. This explanation is but some evidence of the complications in this area and that securing the safety of a customer's funds is a far-from-straightforward task.

### **Trust Accounts**

Thus, in common law jurisdictions such as the United Kingdom, where the concept of *equitable* or *beneficial* ownership exists alongside that of legal ownership, one possible solution is to take steps to create a trust (whether expressly or constructively) in respect of funds deposited in a designated account. This will, for so long as the trust exists and provided it has been properly created, increase the level of protection in respect of those funds by placing the bank in which the funds are deposited on notice that, whilst the gambling operator may be entitled, within the terms of its customer agreement, to call upon those funds for use in gambling, it is not and never has been *beneficially* entitled to the funds held in the trust account.

Beneficial ownership in those funds would remain with the customers who deposited the monies with the operator for the purposes of their gambling unless and until the funds are used to gamble in accordance with the customer agreement. In essence, the arrangements should ensure that customer funds never become the property of the operator, unless and until wagered and lost by the player, or in the case of a P2P operator, until the funds are properly designated as commission or rake.

The use of trust accounts is commonplace in common law jurisdictions, and not only in the gambling sector. For example, in the United Kingdom, lawyers and some other professionals deposit client funds in client accounts which are expressed to be trust accounts. In the event of the insolvency of the professional, there would be no doubt that the funds held in client account are not assets of the professional (and that they never have been) but remain assets of the clients. However, this clarity is partly achieved as a result of express statutory provision in the law and supplementary regulations which provide for how such funds must be held, how such accounts must be designated and managed etc.

In the absence of a similar statutory provision, a company or person may nevertheless seek to establish a trust in respect of the funds held in a segregated bank account, whether expressly or constructively (that is, by course of action) and gambling operators often do. However, whether the monies in such a trust account can be said properly to be fully protected in the event of insolvency or otherwise is questionable.

In the event of the insolvency of such a gambling operator, an administrator will be under a duty to identify and realise the assets of the insolvent operator. In practice, this means that he will scrutinise the trust arrangements very carefully. He will check that the trust arrangements are genuine and have not been imposed over funds properly belonging to the operator, for example in an attempt to defraud creditors. The administrator will not seek to exercise his powers in respect of assets which did not properly belong to the operator, but he will be under a duty to creditors, and to the court, to ensure that assets which do belong to the operator are available for distribution. It is for this reason that practitioners must exercise considerable care in establishing the arrangements for trust accounts to hold customer funds, including with regard to the relevant provisions in customer agreements.

In such circumstances, it is possible that a “trust” might fail. However, where it has been properly established for genuine reasons (ideally *ab initio*) and demonstrably relates to funds deposited by customers on terms which create a trust either expressly or by construction, this is more unlikely. Accordingly, it is considered that trust accounts may offer an effective means of protecting customer funds in the event of an operator’s insolvency.

However, in the event of fraud or other wrongdoing, trust monies nevertheless remain vulnerable. It is conceivable that the directors or officers of a gambling operator who are mandated to give instructions to the relevant bank in respect of monies held on trust on behalf of customers could act in such a way as to betray that trust. Clearly, it is possible to put in place mechanisms which significantly reduce the possibility of a rogue company officer defrauding players in this way, but ultimately, somebody must give instructions to the bank in respect of transfers in and out of the customer account in order to allow those funds be used in gambling. Also, it should be remembered that for the funds to be afforded the protection offered by a trust account they must be deposited there in the first place. It is understood that, at least in the financial sector, it is not unusual for regulatory proceedings to address the improper deposit of customer funds in trading or working capital accounts.

In the case of Worldspreads, because the company operated spread betting in the UK it was regulated by Financial Services Authority (“FSA”) (rather than by the Gambling Commission), and was required under terms of its licence to operate segregated client trust accounts. The company nevertheless collapsed allegedly owing customers at least £12 million. Following the departure of key management in early 2012, new management are reported to have identified and notified to the FSA of “accounting discrepancies” reflecting a significant shortfall of customer funds such as to require the company to cease trading. Its shares were suspended and at the time of writing it is subject to the FSA’s Special Administration Scheme. This was an entity subject to, arguably, stronger regulation than most gambling operators, and which was subject to more onerous licence requirements with regard to the protection of customer funds than it would have been if it had been regulated by the Gambling Commission. Moreover, the terms of its licence required it to employ regulated individuals and to operate trust accounts the status of which could not be revoked. Nevertheless, it failed with a shortfall in its customer accounts.

In practice, weaknesses in any regulatory mechanism may exist. In the case of trust accounts a principal vulnerability arises because individuals are required to instruct on behalf of the operator that its bank move funds in and out of the trust accounts. If they do so fraudulently, or otherwise beyond the scope permitted by the customer agreement, the protection is compromised. Likewise, it is possible that the customer funds are not placed in the designated trust accounts in the first place. Proper internal accounting practices, account reconciliation, in particular between the customers’ interactive gaming accounts balances and the balances of funds held in segregated accounts, as well as the accurate and timely regulatory reporting and robust external audits are all important checks and balances to help to

ensure that a regulated entity is operating as it should, as is careful monitoring by regulatory authorities, but as Peter Dean said no system can offer complete protection.

Another vulnerability of a trust account system is the risk that it is not properly, and lawfully, established in the first place. For a trust account to work it must meet all the legal requirements.

In the case of Full Tilt, the position may have been further complicated, because it is alleged that at least with regard to certain transactions players were allowed to gamble with monies which they had instructed their own banks or card provider to transfer to the operator but which had not actually been received by the company due to payment processing difficulties. If this was indeed the case, it would seem that part of the problems occurred not as a result of a lack of protective measures in respect of the customer accounts, but as a result of internal procedures which allowed players to gamble with money which the operator had not received. This suggests that not only must a regulator require funds to be placed in some form of segregated account but must also seek to ensure that internal procedures are robust and rigorously policed to make sure that customers are only able to gamble with funds which are in fact actually within the customers' account. In the Full Tilt case, the applicable regulations did prohibit affording credit to players<sup>6</sup>, did require reporting of serious events affecting the operation<sup>7</sup>, and did require the provision of accurate regulatory return and accounts<sup>8</sup>. In practice, however, it was alleged that the operator failed to meet these and other licence conditions, and its licences were suspended and most were subsequently revoked.

But the central issue remains that a trust account can be seen to offer a considerable measure of protection for customer funds, although in practice such measures cannot offer full protection, especially against fraud or other wrongdoing, including against identity theft, which is addressed below. It is worth noting however, that exactly the same can be said of customer funds held by non-gambling entities which hold customer funds, including banks, both online and offline.

Trust accounts cannot exist in the same form in countries where there is no recognition of the concept of an equitable or beneficial interest and therefore its concept of trusts is not recognised. In such jurisdictions, in general terms, once the money is transferred to the operator, the legal system will recognise that only the operator is entitled to the funds. Accordingly, in the event of an insolvency of such an operator, such monies are *prima facie* likely to be assets of the operator and available to distribution to creditors as a whole.

However, similar mechanisms to trust accounts can be established which provide that the operator only has a *nominal* interest and not an *economic* interest in the deposited funds and it may therefore be that for "Code" countries this approach may be capable of creating a similar level of protection.

### **Full Reserves**

Of the various mechanisms prescribed by regulators, those at the more restrictive end of the spectrum can be broadly described as a "full reserve", which might be provided either in real cash or secured by way of a bond or similar financial instrument, which is maintained at a

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<sup>6</sup> Alderney eGambling Regulation [ ]

<sup>7</sup> Alderney eGambling Regulation [ ]

<sup>8</sup> Alderney eGambling Regulation [ ]

level at least equivalent to the balances from time to time held on players' interactive gaming accounts. To the extent that they are required to be held in cash, this has broadly the same effect as the trust account mechanism described above, although cash equivalents, bonds and other financial instruments are clearly distinct.

An example of this type of mechanism is that adopted in the regulations promulgated by the Nevada Gaming Commission. Regulation 5A.120 of the Nevada Online Gaming Regulations (the "Nevada Regulations") establishes a detailed series of requirements for all "Interactive Gaming Accounts" (a.k.a. player accounts) subject to the Nevada Regulations including detailed registration requirements and prescribed methods for the deposit and withdrawal or other debits of player funds.

The rules regarding deposit and withdrawal of funds in most jurisdictions tend to be similar and to reflect applicable (and generally quite universal) anti-money laundering requirements. These tend to further enhance the levels of protection of player funds, but again are not the direct focus of this chapter.

In regulation 5A.125 of the Nevada Regulations, the operator is required to maintain a reserve in the form of cash, cash equivalents, an irrevocable letter of credit, a bond, or a combination of these, equal to the sum of all player funds held in gaming accounts (excluding such amounts as may be available to players for play but which are not redeemable by them for cash – such as certain bonus entitlements).

A reserve held in cash form, cash equivalent or maintained by way of a letter of credit, must be held or maintained, as appropriate, by a US federally-insured financial institution. A bond must be written by a *bona fide* insurance carrier (although no US federal regulatory requirement is specified).

The arrangements for the reserve must be made pursuant to a written agreement entered into with the financial institution, either by the operator or on behalf of the operator by an intermediary or agent acceptable to the Nevada Commission.

The Nevada Regulations require these written agreements to "reasonably protect the reserve against claims of the operator's creditors other than the authorized players for whose benefit and protection the reserve is established and must provide that

- a) The reserve is established and held in trust for the benefit and protection of authorised players to the extent the operator holds the money in interactive gaming accounts for such authorised players;
- b) The reserve must not be released in whole or in part except to the Board on the written demand of the Chairman or to the operator on the written instruction of the Chairman. The reserve must be available within sixty days of the written demand or written notice. The operator may receive income accruing on the reserve unless the Chairman instructs otherwise pursuant to Sub-section 10;
- c) The operator has no interest in or title to the reserve or income accruing on the reserve except to the extent expressly allowed in this section;
- d) Nevada law and this section govern the agreements and the operators' interest in the reserve and income accruing on the reserve;
- e) The agreements are not effective until the Chairman's approval has been obtained pursuant to Sub-section 5; and



f) The agreements may be amended only with prior written approval of the Chairman.”

In this case, the Chairman referred to is the Chairman of the Nevada Gaming Commission.

The Nevada Regulations therefore require that operators submit to the Nevada Gaming Commission draft documentation relating to the proposed reserve arrangements for prior approval. The Nevada Board may require amendments so as to ensure compliance with the Regulations. Amendments to the documents must similarly be pre-approved. In this way, and in accordance with the Regulation quoted above, the Commission interposes additional prescriptive requirements in relation to the reserve, which involve a greater regulatory burden than merely requiring customer funds to be held on trust.

The Nevada licensee is required to calculate its reserve requirements on a daily basis and, where an operator determines that its reserve is insufficient to cover the calculated requirement, it must within 24 hours notify the Board of this fact in writing and indicate the steps it proposes to take to remedy the deficiency.

Moreover, the operator must engage an independent certified public accountant to audit the reserve records on a monthly basis and to examine whether the reserve amounts required by the Regulations for each day of the previous month were met. The operator is obliged to make available whatever records are necessary to the accountant and the accountant is required to report its findings in writing to the Board and to the operator no later than the tenth day of the month following. This report must include the operator’s statement addressing those days on which it did not comply with the reserve requirements and the corrective measures taken.

It is noteworthy that the Board can authorise this report to be provided by an employee of the operator or an affiliate provided that the employee is independent of the operation of the interactive gaming<sup>9</sup>, although in practice this would appear potentially to weaken this aspect of the overall mechanism.

The Board can demand that the reserve is increased to correct any deficiency or otherwise for good cause. However, if the reserve exceeds the requirements of the Regulations the Board must, upon the operator’s written request, authorise the release of the excess.

Significantly, where an operator ceases to operate and its licence is either surrendered, revoked or lapses, the Board may demand payment to it of the reserve and any interest accruing on it after the operation has ceased may interplead the funds in a Nevada State District Court for distribution to the players. The reserve may also be paid to such other persons as the Court may determine are entitled to it and the Board may take such other steps as are necessary to effect the proper distribution of the funds.

The Nevada Regulations further require that, in addition to the reserve, an operator must maintain cash equal to 25% of the total amount of player funds held in customer accounts (excluding those funds not redeemable for cash) together with the full amount of any progressive jackpots related to interactive gaming.

Failure to comply with any provision in the Nevada Regulations, insofar as they relate to operational matters, will be evidence of unsuitable methods of operation and grounds for disciplinary action. The Commission may impose licence conditions and other regulatory

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<sup>9</sup> Nevada Regulation 5A.125 paragraph 7

sanctions including suspension, revocation of licences and fines on the finding of any disciplinary matter.

The Nevada Regulations require interactive gaming service providers (such as B2B operators) who act for or on behalf of an operator in performing services of an interactive gaming service provider to comply with the same Regulations to the extent that an operator must. Nevertheless, an operator remains obliged to ensure, and remains responsible for, compliance with the Regulations regardless of the delegation of any operational responsibilities to an interactive gaming service provider.

It can readily be seen that these arrangements place a far greater burden of compliance on a licensed operator than merely to maintain a segregated trust account for player funds, and by incorporating significant reporting obligations (including monthly independent audits of the reserve) and monitoring and enforcement rights, the Nevada Regulations aim to create a more robust and reliable mechanism. Not only must the necessary funds (or their equivalent) be held in the relevant accounts (or be provided for) but they must be seen to be held or provided for, as appropriate, and very regular reconciliations and reporting will significantly reduce the risk of misappropriation.

With such regulatory prescription it is less conceivable that player funds would be endangered in the event of insolvency, absent any misappropriation by the operator or a third party.

## **Malta**

Similar, though less prescriptive, arrangements with regard to the segregation of player accounts are required by the Lotteries and Gaming Authority (LGA) in Malta. Specifically, licensees are required to keep player funds in segregated accounts and with a credit institution approved by the LGA. The funds held in such segregated accounts (but including the funds in transit or in the process of being cleared by the banking system or credit card processors), must be at least equal to the aggregate amount standing to the credit of players in their interactive gaming accounts. To the extent that there is any shortfall, this must be made up by the licensee from its own funds within a period of 30 days following the end of the month in which the shortfall occurs<sup>10</sup>.

The credit institution is required to declare and affirm in writing that it will not attempt to enforce or execute any charge, write-off, set-off or any other claim against the client account, that it will not combine the client account with any other account in respect of which there is a debt owed to it by the licensee and that it will credit any interest payable in respect of the client account only to that account<sup>11</sup>. The licensee is required to provide copies of these affirmations to the LGA<sup>12</sup>.

In addition to these default requirements, the LGA may, for just cause, require by means of a directive that the licensee takes out a bank guarantee in favour of the LGA in such amount and for such period of time as may be determined by the LGA and if the licensee fails to comply with this requirement within three working days of the issue of the directive, the LGA may suspend the licence. However, such a bank guarantee requirement does not to affect the

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<sup>10</sup> Maltese Remote Gambling Regulations, [ ]

<sup>11</sup> Maltese Remote Gambling Regulations, [ ]

<sup>12</sup> Maltese Remote Gambling Regulations, [ ]

requirement regarding the sufficiency of player funds in segregated accounts as described above.

Finally, the licensee must instruct and authorise the financial institution which holds the player funds to disclose such information as may be requested by the LGA in respect of players' accounts.

These requirements are more prescriptive than those of other leading European remote gambling jurisdictions, and bear some obvious similarities to the Nevada Regulations, although the Nevada regulations are certainly more demanding, in particular by requiring a monthly audit by an independent auditor of the client accounts.

## **Great Britain**

A far less prescriptive approach to how customer funds are maintained is currently exercised by the Gambling Commission in Great Britain. Gambling operators licensed by the British Gambling Commission pursuant to the terms of the Gambling Act 2005 are subject to a series of Licence Conditions and Codes of Practice attached to their operating licences, many of which are specific to remote gambling operating licence holders, given the distinct nature of the provision of interactive gaming services. The Gambling Commission maintains this suite of conditions and codes of practice, in addition to its remote gambling and software technical standards, which set out a series of operational and technical specifications.

The Licence Conditions and Codes of Practice include the following condition which applies to all remote operating licences (with the exception of ancillary remote licences, which are limited to remote gambling which is ancillary to terrestrial gambling, for example hand-held devices for gaming within licensed premises such as a casino):

### “Protection of Customer Funds

Licensees who hold customer funds for use in future gambling must set out clearly, in information made available to customers in writing, whether they protect customers' funds in the event of insolvency and the method by which this is achieved.”<sup>13</sup>

Whilst the Gambling Commission obviously undertakes very careful scrutiny of licence applicants, their ownership, management and financial standing, and has ongoing monitoring and compliance functions and may impose such specific licence conditions as it thinks fit, the licence condition set out above is the only general licence condition relating directly to how customer funds are to be protected in the event of insolvency of a British remote gambling licensee.

There are reporting requirements with regard to key events which may have a significant impact on the nature or structure of the licensee's business and which must be notified to the Gambling Commission as soon as reasonably practicable and in any event within five working days of the licensee becoming aware of the event's occurrence. These include, in the case of licensees which are companies, the presentation of a petition for the winding-up of the company or any group company, and, in the case of individuals the presentation of the petition for their bankruptcy or sequestration, or their entering into individual voluntary arrangements with creditors. Also, where licensees are required to have their accounts independently audited, any unplanned change of auditor including a change prompted by a

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<sup>13</sup> Gambling Commission “Licence Conditions and Codes of Practice” (December 2011), General Condition 4.

dispute or resulting from the auditor being unable or unwilling to sign an unqualified audit report must be notified as a “key event”, as must the departure of certain key individuals, any breach of a banking covenant or covenant with any other lender, any default in the repayment of the whole or part of any loan on its due date, the fact that a Court judgment remains unpaid 14 days after the date of the judgment and the commencement of any material litigation.<sup>14</sup>

There are other reporting requirements, including in the event of any suspicion of an offence having been committed under the Gambling Act, as well as requirements with regard to provision of general and regulatory returns which include the provision of detailed information with regard operational matters. Nevertheless, British regulation remains noticeably non-prescriptive with regard to provision of specific protections for customer funds.

The British Gambling Commission’s Remote Gambling and Software Technical Standards do require the provision of detailed customer account information via the interactive gaming service (online, on mobile or through interactive television), which are intended to ensure that customers can access up-to-date information with regard to their current balances, movement of funds between products and the like. However, these provisions are designed to allow customers to understand easily the status and activity of their account, but do not directly address the issue of protection of the funds held on behalf of the customer against creditors of the licensee’s business (including other customers) or the wrongdoing of the licensee or others.

However, the Gambling Commission is entitled to impose such licence conditions as it thinks fit<sup>15</sup>, albeit that the imposition of a conditions may be the subject of the general appeal process provided for in the legislation, and an unreasonable or disproportionate condition may possibly be set aside by the Gambling Appeals Tribunal.

However, much of this is theoretical. Since, at the time of writing (May 2012), British law permits the promotion of gambling services in the United Kingdom or to UK residents by operators who are not licensed by the Gambling Commission, provided they are licensed in the European Economic Area, which for the purposes of the Gambling Act includes Gibraltar, and the “white listed” jurisdictions. The white list includes Alderney, the Isle of Man, Tasmania and Antigua.

The effect of this has been to discourage remote gambling operators from establishing their operations in Britain and thus of having to obtain licenses and pay remote gaming and/or betting duty, plus direct taxes in Great Britain. Instead, those targeting British residents have generally established themselves in low-tax or no-tax jurisdictions on the “white list”. And some British operators have moved their interactive gambling operations offshore to take advantage of this anomaly. Accordingly, with one or two notable exceptions, the British Gambling Commission tends not to regulate significant online operations. It is probably fair to conclude from this that the effectiveness of the provisions with regard to protection of customer funds (or, more accurately, with regard to notifying customers whether or not their funds are protected) have not particularly been tested<sup>16</sup>.

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<sup>14</sup> Gambling Commission “Licence Conditions and Codes of Practice” (December 2011), General Condition 15.2

<sup>15</sup> Gambling Act 2005, Section 77

<sup>16</sup> NB. The collapse of Sporting Options predated the Gambling Act 2005 which came into force in September 2007 (and the creation of the Gambling Commission itself).

## **Gibraltar**

A similarly non-prescriptive approach to that exercised by the British Gambling Commission is used by the Gibraltar Regulatory Authority (GRA), which has close connections with the British system. In Gibraltar, whilst there is a considerably less prescriptive approach than in some other leading jurisdictions, the regulator nevertheless pursues a notably “hands on” approach with its licensees, partly as a result of the importance of the industry in the jurisdiction, and partly due to the geographic proximity of the licensees to the regulator, Gibraltar being such a physically small jurisdiction.

The GRA approach places considerable importance on the initial licensing stage, and historically, Gibraltar licences have generally been awarded only to operators of significant size and financial substance who have a demonstrable records of regulatory compliance. In that sense, the “contextual” factors briefly discussed above are perhaps more significant aspects of the consumer protection regime in Gibraltar than in many other jurisdictions. That is not to say that such factors are not of critical importance to other regulators, but Gibraltar is an example of a jurisdiction which relies to a larger extent on such indirect means of ensuring consumer protection than some others. In essence, the GRA’s perspective seems to be that ultimately it is the fitness and propriety of the operator, as well as its financial standing and integrity, which is the most significant factor in ensuring that player funds are adequately protected.

Nevertheless, the GRA does require its licensees to offer an appropriate level of protection for customer deposits, which may be a combination of measures, using a risk-based approach, taking into consideration the size of the operation, the products offered and the extent of customer deposits (which may depend for example, in the poker context, not only on the size of the operator, but the value of the games and profile of the customer, who may be higher rollers on some websites than others).

The GRA champions a bespoke approach based on relative risk, according to numerous factors some of which have been touched upon briefly in this section. Such a bespoke approach is considered further in the conclusions to this chapter.

## **Alderney**

The Alderney Gambling Control Commission (AGCC) has entered into Memoranda of Understanding with numerous international gambling regulators including the Nevada Gaming Commission and a number of regulators in Europe and has been at the forefront of the development of remote gambling regulation since its inception. Nevertheless, its online gambling regulatory regime has recently faced considerable scrutiny, including with regard to the protection of customer funds in the hands of its licensees, because it was the regulator of Full Tilt Poker.

The Alderney e-Gambling Regulations 2009 provide that e-gambling licensees may not have recourse to funds standing to the credit of a registered customer except to debit amounts payable in respect of gambling transactions at the direction of the customer, to debit inactive funds in accordance with terms and conditions of its approved internal control system accepted by the customer prior to the addition of the funds, and to facilitate player to player transfers as directed by the customer in accordance with approved terms and conditions.

Regulation 243 requires that Category 1 e-gambling licensees (that is B2C operators) must at all times satisfy the financial ratios established by the Commission and must by no later than the 20th day of each month submit to the AGCC a report detailing their financial position in the preceding calendar month by reference to the ratios. Category 2 e-gambling licensees

(B2B), temporary licensees and foreign gambling associate certificate-holders (that is, certified non-Alderney associates) must provide similar reports for the purpose of satisfying the Commission with regard to their financial position.

The AGCC financial ratios require that at all times operator assets exceed liabilities, that cash exceeds player balances, and that total assets exceed total liabilities by at least 25%. Readers will note certain similarities to the Maltese and Nevada Regulations in this regard. However, like the British Gambling Commission, the AGCC does not (at the time of writing) specifically require all licensees to hold player funds in segregated accounts.

The AGCC's Internal Control System (ICS) Guidelines do however require (at paragraph 2.9.2) that the licence applicant must state exactly how customer funds will be held by identifying which of the three categories best describes its proposed arrangements:-

1. Not segregated or protected (for example where customer funds are co-mingled with corporate funds both in terms of being in the same bank account and for internal bookkeeping purposes).
2. Segregated but not protected (where the customer funds are informally segregated from corporate funds by holding them in separate bank accounts but not formally titling such accounts as "client accounts" or by indicating separation by way of internal bookkeeping).
3. Segregated and protected (with customer funds formally segregated from corporate funds by way of separate bank accounts entitled "client accounts").

Where a licensee does not hold player funds in a segregated protected manner it must inform its customers that they are unprotected. Licensees that do hold customer funds in a segregated and protected manner may inform their customers that they are so protected and that this has been validated by the AGCC. The AGCC requires copies of bank statements for each bank account to be appended to the ICS.

Accordingly, the present position (in May 2012) is that the AGCC does not require a particular mechanism to be used by operators as a matter of course, although it does require a clear notification to players of the level of protection which is provided, and in common with other regulators which adopt a similar approach (such as the British Gambling Commission) it has the power to impose specific conditions on licensees to address particular regulatory risks.

In the Full Tilt Poker Review referred to above, Peter Dean disclosed that the AGCC had recently reviewed the options open to it and is "tightening up its supervision of player funds on a risk-assessed basis". However, at the time of writing, there is no publicly available information on what measures might be required by the AGCC. Given the nature of the analysis in this chapter, it is regrettable that the question of how player funds can best be protected fell outside the scope of his review, so Mr Dean did not make any specific recommendations other than for the AGCC to continue to make plain on its website what degree of player protection it requires of its licensees. It will be very instructive to see in due course what conclusions the AGCC draws from the events and what measures it introduces.

## **IAGR eGambling Guidelines 2008**

The general approaches adopted in Great Britain, Gibraltar and Alderney reflect (and are likely to have significantly influenced) the eGambling Guidelines published in 2008 by the

International Association of Gambling Regulators (IAGR)<sup>17</sup>, which were an attempt to provide good practice guidance and to establish minimum criteria but without prescribing any particular methods to achieve the aims identified. This approach, recognising that there are generally more ways than one to achieve (or seek to achieve) desired regulatory goals, certainly reflects the approach of the British, Gibraltar and Alderney regulators to date.

In addition to recommendations regarding how customer accounts should be managed, IAGR recommended that:

“Operators must provide information to customers about whether they protect customer funds and the methods which they use to do so and about how they deal with unclaimed funds from dormant accounts”<sup>18</sup>.

The IAGR guidelines were derived from work undertaken by the IAGR eGambling Working Group in 2006, so some time has passed since the preparatory work on them, and they expressly acknowledge that the industry is dynamic and fast moving and that the working group will continue to consider developments in eGambling and where appropriate propose amendment to the guidelines. It is understood that the GRA has recommended to IAGR that a bespoke approach should be promoted, with greater measures applicable in higher risk situations.

### **Continental European Approaches to Player Fund Protection**

The development of regulated online gambling markets in certain continental European countries over the last decade has given rise to a series of different treatments for the many regulatory challenges presented by online gambling, including with regard to the protection of customer funds.

The majority of these jurisdictions require operators to deal with their residents on a country-specific URL basis, meaning for example that an operator who may transact with worldwide customers on its “.com” website, must establish an entirely distinct operation using a “.it” site for Italy and a “.fr” site for France, even though there may be certain common back office functions provided to the various sites.

The desire for such jurisdictions to ensure that their residents play on “ring-fenced” sites and are not mixed with players has tended to mean that the default position with regard to customer funds is that they too must be ring-fenced from the funds of customers playing on the operator’s other websites. This too has tended to lead to prescriptive requirements with regard to the terms on which such funds are held generally.

#### **Italy**

It is thought by many that the Italian online gambling regulatory system is somewhat unusual in that the regulator Amministrazione Autonoma Dei Monopoli Di Stato (AAMS) effectively enters into a tripartite contractual arrangement with the licensed gambling operator on the one hand and each that operator’s players on the other.

The standard AAMS licence agreement at paragraph [14.1(o)] requires a licensed operator to open dedicated bank accounts in the name of the operator into which all deposited funds must

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<sup>17</sup> IAGR eGambling Guidelines, 8 September 2008

<sup>18</sup> IAGR eGambling Guidelines, 8 September 2008, 3.2.6.4

be placed. The licence agreement provides that these deposited funds can only be used for transactions authorised by the relevant players in accordance with approved customer agreements. They are therefore held in segregated accounts and the funds cannot be co-mingled with the operator's money.

Further, if player funds which were deposited in a dedicated player account have not been used by that player for a period of three years the operator may be required to transfer the money to AAMS.

Moreover, AAMS requires under its standard licence agreement the provision of customer and transaction data to its Central Control System, allowing it to monitor operational matters including the position with regard to player funds in real time. The data relating to deposits of funds into client accounts is therefore stored not only in the operator's own system but also in the Central Control System established by AAMS. AAMS habitually monitors the segregated client accounts and checks the reconciliation of the monies held in those accounts with data relating to interactive gaming accounts held in the name of players with licensed operators.

As part of the licensing process, licensees must accept the AAMS service chart which specifies certain requirements with regard to the transparency of gaming accounts and the safety and privacy of player data. This service chart stipulates that all funds in player accounts must be immediately recognisable by the Central Control System and in turn that the player must also be able to see his own account details and evidence of any funds he has used in interactive gambling.

The tripartite relationship between the operator's platform, the Central Control System and the player involves a real-time connection between the operator's platform and the Central Control System which is assured by compliance with certain communication protocols which in turn require that relevant data is uploaded to the Central Control System. These protocols are product- and sector-specific and there is a specific communication protocol relating to game accounts which addresses all of the data which AAMS requires to see in real time on the Central Control System.

The gaming platform must be certified by an accredited testing laboratory and must also pass connectivity and communication protocol tests between the operating platform and the Central Control System before the operator can go live.

The operator's platform may be located on servers anywhere within the European Union, but the Central Control System is located in Rome.

## **France**

The French regulator, L'Autorité Administrative Indépendante de Régulation des Jeux en Ligne (ARJEL), oversees a similar regime to the Italian model, although the monitoring by ARJEL is more passive. Licensees are required to transact with French players only on ".fr" servers (the so-called "frontal opérateur") located in France, although they are permitted to provide supporting transactional services from elsewhere, on the "platform opérateur".

International players may be served through this site, but the operator may not deal with French players on its ".com" or other websites. French player funds must be segregated not only from the operators funds but also from those held on behalf of international players. French player funds must be held in an account held with a French bank.

Operators must provide technology to allow the customer accounts to be monitored and transaction to be audited.



The system overseen by ARJEL contains a raft of particularly onerous regulatory requirements, a number of which relate to customer account protections, although some of which [may be] discussed elsewhere in this text. For example, on registration, a player must send physical identify verification documents to the operator (or its agent) by post. Similarly, the operator must send an account verification code to the player at his registered address. Such measures provide heightened security, but are very costly, slow down the completion of the registration process and lead to high customer registration attrition rates. They are unpopular with international operators who do not have to deal with comparable measures in other jurisdictions and who argue that the costs undermine their ability to provide consumer choice and value.

The French model is typically enigmatic. On the one hand it takes very seriously such issues as customer account protection and aims to require some measures which (even though they may be unwieldy) arguably offer greater protections against, for example, fraud. But on the other hand, the logistical difficulties and costs of compliance imposed (taken together with an aggressive tax regime) have meant that even some leading operators are struggling to make reasonable returns on their investment in the market. Some big names have withdrawn and anecdotal evidence suggests that players are actively seeking unlicensed operators, who offer better odds, choice and liquidity. Without wishing to generalise too greatly, some aspects of the French regime, although well intended, seem to be self-defeating.

## **Denmark**

The Danish online gambling regulations also require an operator to establish a player funds account segregated from any other bank accounts, which must have a balance equal to all player balances including deposits and actual winnings not yet credited to customers, but does not need to include an amount equal to potential winnings on outstanding bets. To that extent, it may not always cover the operator's potential exposure to players.

The relevant bank is required to issue a declaration promising not to seek any fulfilment from funds held in the account. The account has the status of a client account and is equivalent to a trust account. It must be reconciled against customer balances at least once every 24 hours.

With regard to data security, the Danish gambling regulations take advantage of the fact that all Danish citizens are issued as a matter of course with an identification number. The individual players are required to use their identification number each time they log in to gamble and the Danish regulatory authority issues each player with a series of four-digit PIN numbers [six-digit?] which are required to be used each time the customer logs on. Each PIN code can only be used on one occasion and the PIN codes must reconcile with the identification number of the authorised player. By this method, a greater level of data security is ensured by minimising the possibility of identity theft with respect to the gaming.

## **Conclusions regarding protection of Customer Funds**

Perhaps the very least that regulators should require of licensees is for them to establish segregated and protected bank accounts into which all player funds must be deposited. Whether or not such accounts are described as "trust" accounts they should, if properly established, prove of value in ensuring that such funds as are held in them are not vulnerable in the event of an insolvency of an operator.

Of course, such measures do not prevent misappropriation, and it is obvious that the imposition of technological means for monitoring either in real time or on a very regular basis the reconciliation between the amount of funds held in respect of player liabilities and the

balances on players' interactive accounts will reduce the risk of misappropriation, whether by the operator or by third parties.

Perhaps the most complete measure is a requirement to have in place a bond or other financial instrument guaranteeing an amount at least equivalent to the balance of player funds from time to time, as this does not require the funds themselves to be held in a particular way, and cannot itself be "dipped into". Of course, there are logistical obstacles to the successful implementation of such a measure, including the constantly fluctuating, and potentially ever-increasing amounts of player funds deposited with the largest operators. But such a bond could form an effective anchor for a suite of measures put in place by a responsible and well-regulated operator.

However, all of these measures carry with them considerable costs of compliance – especially any form of insurance or a requirement, such as that of Nevada, to maintain an excess of cash over and above the amount of player funds. There will always be resistance from certain operators and there may be a temptation among regulators to afford more latitude to certain operators (of certain types of operation), especially where some regulators might be said to be (to some extent) in competition amongst themselves for licence applications<sup>19</sup>. And a risk-based approach may be reasonable provided that the assessment of risk is appropriate. Not all operations present the same type or level of risk. However, one of the consequences of the Full Tilt problems may in particular be greater customer awareness of the potential risks and a consequential heightened scrutiny of the measures put in place by operators at the behest of their regulators.

Whilst the Nevada approach is admirable in its assiduousness, and may present a gold standard for customer funds protection with regard to poker (to which the Nevada Regulations are currently limited), it does not necessarily lend itself well to the regulation of all forms of gambling. For example a small online betting operator holding no large customer balances does not present a comparable regulatory risk. So a balanced approach may continue to make sense. And for those regulators, such as the AGCC, the GRA and the British Gambling Commission, who regulate non-poker operators (as well as poker operators) a risk based approach seems to be a suitable approach, provided always that the assessment of risk is appropriate, suitable monitoring is undertaken of operators who present the greatest risks, and the default position (i.e. minimum requirement) for all operators is that customers funds be placed in trust, or similar, accounts. Of course, this is not currently the case with all such regulators and it remains to be seen whether and how all regulators individually, and collectively through organisations such as IAGR and GREF (Gambling Regulators European Forum), choose to develop their requirements.

### **Other Customer Account Protections**

Controls regarding deposit and withdrawal of funds.

Identification theft.

Password strength; double password/UserID protection; requirements for password updating; comparison to online banking requirements. Security keys (reference Poker Stars VIP

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<sup>19</sup>Full Tilt Review, Report by Peter Dean to the AGCC, 26 March 2012, paragraph 34

security option. Danish model. Data sharing. [Query whether these matters will be dealt with under fraud prevention?].

### **Data Protection and Privacy**

Compliance with local data protection laws. Notices, fair processing, informed consent.

International issues: data transfer

EU Data Protection Issues: Data Protection Directive.

US Data Protection: Safe Harbor.