

# Memorandum

**To:** Tracie Stevens, Chairwoman  
Steffani Cochran, Vice-Chairwoman  
Dan Little, Associate Commissioner  
National Indian Gaming Commission

**From:** Tribal Gaming Working Group

**Date:** 5/15/11

**Re:** Proposed Revised Class II Minimum Internal Control Standards and Technical Standards

---

Encouraged by the National Indian Gaming Commission's (NIGC's or Commission's) recognition of the need for a regulatory review, particularly in relation to Parts 543 and 547 of its regulations, a coalition comprised of representatives of the Class II tribal gaming industry, including tribal elected officials, tribal gaming regulators, tribal gaming operators, gaming equipment manufacturers, gaming suppliers, gaming laboratories, tribal organizations, gaming attorneys, and a broad spectrum of technical experts reconvened the Tribal Gaming Working Group (TGWG). The Commission's notice of regulatory review published in the Federal Register on November 18, 2010, further encouraged TGWG to continue its work. Over a period of approximately 7 months, we completed an exhaustive review of Parts 543 and 547 of the NIGC regulations, and developed a proposed revision of both parts for the Commission's review and consideration for possible promulgation. This effort included six in-person meetings in various regions of the country and numerous teleconferences; prior notice and all work product were distributed via email to over 400 recipients. The result of this effort is attached to this transmittal memorandum, which provides a summary explanation of the TGWG's proposed revisions.

The members of the TGWG recognize that a lawful, robust, and well-regulated Class II gaming environment serves both the tribal and federal interests. The Indian Gaming Regulatory Act (IGRA) is premised on a close cooperative and collaborative relationship between tribal governments and the NIGC in which each is assigned a specific regulatory function with tribal gaming regulatory authorities shouldering the primary regulatory responsibility for Class II gaming and the NIGC providing regulatory oversight. This regulatory framework can only succeed if tribal governments and the NIGC work together in a cooperative and complementary manner, and it is in this spirit that the TGWG proposed revisions are offered.

## **I. Background**

The TGWG was assembled in December, 2006 to assist the NIGC's Tribal Advisory Committees with the initial development of Parts 543 and 547. At that time, the NIGC had been poised to

promulgate Class II regulations that the technical working group believed would be devastating to the continued viability of Class II gaming. As reported in the NIGC's preamble to its publication of 25 C.F.R. § 547: "The tribal representatives to the advisory committee formed a working group, which met at various times, in person and telephonically, from the end of 2006 through the middle of 2007 to draft this new set of technical standards. The Commission did not participate in the establishment of this working group or in most of its work. On some occasions, the tribal representatives invited the participation of Commission staff members to answer questions and to provide explanation about the Commission's regulatory goals." 73 Fed. Reg. 60509 (October 10, 2008) The Commission's technical standards, as promulgated, incorporated the vast majority of the TGWG's recommendations.

Following the working group's submission of its technical standards product to the NIGC, the group continued active work with the NIGC's tribal advisory committees to assist in providing expertise to the crafting of Class II technical standards and MICS. The TGWG continued to meet in association with the Tribal Advisory Committees working on those regulations, and continued to solicit input from sources encompassing tribal operators and regulators as well as manufacturers and gaming laboratories involved with Class II gaming.

The TGWG expressed concern with the Class II MICS as promulgated by the NIGC, and continued developing analyses and alternative proposals better suited to protect the integrity of Class II gaming. In this context, the NIGC's deferral of the effective date of its Class II regulations, followed closely by the Commission's announced intention to review existing regulations, spurred the TGWG to heightened activity. The TGWG was reactivated, overseen by tribal regulators, to provide the best possible input for the NIGC's effort to review and improve its Class II regulations. This product is the result.

## **II. Overview – Part 543. Minimum Internal Control Standards for Class II Gaming**

The stated purposes of IGRA are to ensure that tribal gaming revenues may be used to strengthen tribal governments, to protect tribal gaming revenue, and to prevent unsuitable or corrupt persons from participating in the operation and management of tribal gaming activities. The very success of the tribal gaming industry is dependent upon ensuring integrity in the operation of tribal gaming activities, which, in turn, is dependent upon the existence of a strong regulatory framework consistent with the provisions of IGRA. Parts 543 and 547 of the NIGC's regulations apply exclusively to Class II gaming activities where the regulatory relationship between the NIGC and tribal governments is strongest. Ironically, it is in the Class II arena that the clash between tribal and federal views has been the most contentious.

A major goal of the TGWG has been to develop a revised set of Class II regulations that accord with the respective regulatory roles of the NIGC and tribal governments consistent with the regulatory framework set forth in IGRA. The revised MICS for example reflect the NIGC's authority to establish baseline or minimum standards for Class II gaming, while respecting the role of tribal gaming regulatory authorities to promulgate more detailed and/or comprehensive standards (tribal internal control standards or TICS) upon which each gaming operation will develop and operate under a comprehensive system of internal controls subject to the regulatory authority of tribal gaming regulatory authorities and, where appropriate, that of the NIGC.

A major concern with the NIGC's Minimum Internal Control Standards (MICS) from the tribal perspective has long been that the MICS were mixed up, so to speak. In other words, the provisions were lacking in "standards" and heavy on procedure. Borrowed largely from the regulations and guidance documents promulgated by the Nevada Gaming Control Board, the NIGC MICS were not reflective of the tribal environment upon which they were appended nor did they reflect the nature of the NIGC's more limited oversight role. Try as one might, simply plunking a state regulatory framework into the tribal Class II gaming environment is not a workable endeavor. The Nevada regulations are premised upon a direct relationship between the State and commercial gaming operations. The Class II regulatory framework is premised on a much more limited federal role with tribal gaming regulatory authorities serving the primary regulatory role.

This, however, is not to say that the Nevada regulations are lacking in utility, and the Commission should note that the TGWG's revised draft MICS do not significantly deviate from the basic structure or subject matter contained in Parts 542 and 543 of the current MICS. No sections of the current MICS were deleted, though some sections were added and some sections were re-arranged. We noted, for example, that in some cases provisions pertaining to certain kinds of functions were scattered throughout several subparts. The Cage subpart, for instance, contained provisions relating to surveillance. Since the responsibility for meeting the standard fell to the surveillance function, those provisions were moved from the cage subpart and were incorporated into the surveillance subpart. Some subparts were brought together to form a new subpart. Audit and accounting standards, for instance, were grouped together due to the interrelatedness of the two functions.

Another issue tackled by the TGWG was the vernacular used in the present Class II MICS. The source of the problem in this regard is that much of Part 543 was simply lifted out of Part 542 and dropped in. Part 542, of course, pertains to Class III gaming which by definition is distinct and separate from Class II gaming. Since many terms applicable to Class III gaming are simply not applicable in the Class II arena, they were removed from the definition section. In some cases, the current regulation contained definitions that were not used at all in the body of the regulations. These definitions were deleted as well. In some instances definitions not included in the existing rule were added and other definitional revisions were made to ensure that those used in Part 543 were consistent with definitions contained in Part 547.

The Commission will note that the TGWG proposed revision to part 543 is more condensed than the existing rule. A major factor for this is that although the tier system is retained, the proposed revision does not contain separate subparts for each tier; rather the exceptions or alternatives for tiers A and B are simply referenced in the applicable provisions. This revision significantly reduces redundancies in the regulation and makes it a more concise and more readily understandable document. Another factor is that a considerable amount of the procedural provisions were deleted from the proposed revision. However, the TGWG is in the process of incorporating these procedural provisions in detailed sets of guidance documents, which provide explanations as well as additional provisions that can be adopted or adapted by tribal gaming regulatory authorities as Tribal Internal Control Standards (TICS). The TGWG is also preparing checklists to go along with the guidance documents, which may then be issued by the NIGC in the form of bulletins or "best practices" guidance documents for possible publication on the NIGC website.

The TGWG is confident that the approach described will solve the longstanding imbalance in the existing MICS, which is overly detailed and prescriptive in some sections while somewhat vague and unclear in others. The TGWG approach will help ensure that those tribal governments in need of greater guidance due to size, experience, or other factors will be able to take advantage of comprehensive guidance documents. The TGWG is in the process of completing work on these guidance documents and checklists, and will be submitting the work products to the NIGC shortly.

Harkening briefly back to the proposed new audit and accounting section, one of the developments in the NIGC's previous MICS revisions was the incorporation of certain professional or industry standards into the MICS, such as GASB, GAAP, FASB, and SSAE. It was the TGWG's view that since these standards have been incorporated by reference into the MICS, and since they independently apply to accounting and auditing professionals, it is unnecessary to restate these standards in the MICS. Doing so needlessly expands the size of the MICS and could create conflicts between the language included and future revisions of these standards; although we did include language making clear that any conflict between the text of the MICS and such standards will be resolved in favor of the incorporated standards in order to maintain currency.

Another feature of the new proposed audit and accounting standards is that the TGWG added some additional terminology to better reflect the nature of the audits performed on tribal gaming operations. It's important to note that in many instances, the internal audit function is performed by tribal gaming regulatory authorities rather than internally by the gaming operation itself. We believe that this circumstance provides far greater independence in relation to the function than a gaming operation could achieve on its own. Also, we revised the term "revenue audit," substituting the term "operational audits." The reason for this is to distinguish between this type of function, which is in the nature of an accounting function performed by the accounting or finance departments of a gaming operation and the performance of periodic independent audits.

Another issue with the MICS addressed by the TGWG was the inclusion of a new subpart specifically addressing promotions. Some language pertaining to promotions is contained in the existing MICS in the Bingo Subpart. However, Part 543 pertains to other types of Class II gaming and it was the TGWG's view that the provisions pertaining to promotions should not be limited solely to Bingo. Similarly, the provisions pertaining to patron accounts and cashless systems was removed from the Bingo section and given its own subpart. Two types of patron accounts are reflected in the proposed revision - restricted and unrestricted - as a means of ensuring that technology used to operate certain Class II gaming systems is covered by the MICS.

The existing MICS contains a subpart entitled IT, which refers to "Information Technology." Use of this terminology is confusing because the standards are actually related to the security and management of servers, server software and data associated with Class II Gaming Systems rather than the management of data storage alone. Hence use of the term "IT" is a misnomer, which the TGWG corrected in its proposed revision by creating a new subpart entitled, "What are the Minimum Internal Control Standards for the Security and Management of Servers, Server Software and Data associated with Class II Gaming Systems?"

Another improvement offered by the TGWG was the inclusion of a variance subpart. The existing Part 543 incorporates by reference the variance subpart in 542 which is applicable only to Class III gaming. In the view of the TGWG this operates to make Part 543 more difficult to use as it requires the user to flip back and forth between two separate and unrelated parts. All references to Part 542 were replaced to make this regulation easier to use.

Finally, the TGWG endeavored to incorporate standards that are clear, concise, technically correct with regard to terminology, and which make clear the harm the controls are intended to prevent. At the beginning of each subpart standard provisions are included, including language explaining the intent of such controls. With regard to complimentary services and items, for example, the language reads, “Controls must be established in a manner designed to prevent unauthorized access, misappropriation, forgery or fraud. Such controls must include, but not be limited to....” It is the TGWG’s view that it is important to the proper implementation of the standards that tribal gaming regulators clearly understand the purpose and intent of each control standard. Such understanding will further operate to ensure that such understanding will aid tribal gaming regulators in developing and enforcing comprehensive tribal internal control standards.

### III. PART 547 – Class II Technical Standards

In the words of the NIGC as stated in the preamble to Part 547 as initially published in the Federal Register, the purpose of the regulation is to establish technical standards to ensure the security and integrity of Class II games played with technologic aids, to ensure the auditability of the gaming revenue that those games earn, and to account and allow for evolving and new technology. With the assistance of a tribal advisory committee supported by a technical working group, the NIGC succeeded in the promulgation of a regulation designed to achieve such purposes.

Overall, Part 547 represents a sound regulation that has brought increased stability and clarity with regard to electronically aided Class II gaming. Accordingly, the TGWG’s proposed revisions of Part 547 are largely technical in nature and tailored to render increased clarity, particularly in relation to terminology. The definition of “reflexive software” in the proposed revision, for example, was enhanced to make the definition more consistent with the industry understanding of the term and to more clearly identify the harm the regulatory prohibition is intended to prevent. The definition now reads, “Any software that has the ability to manipulate and/or replace a randomly generated outcome for the purpose of changing the results of a Class II game *‘or deprives a player of a prize to which the player is otherwise entitled based on the random outcome of the game.’*” Similar clarifying language or examples were added to several definitions for this same purpose.

A substantive proposed revision offered by the TGWG concerns the “grandfather provision,” which establishes a five year limit on the use of grandfathered Class II gaming systems. In the TGWG’s view, this provision is severely problematic. In the first place, most, if not all, of these grandfathered gaming systems have been operating without safety or integrity issues for many years. Moreover, to qualify for grandfathering status, the gaming software systems were required to be submitted to independent game testing laboratories for certification that the gaming software was compliant with non-waiveable provision governing the integrity of the

grandfathered systems set forth in subpart 547.4. Under these circumstances, it strikes the TGWG as arbitrary and capricious for an agency to require the removal of such gaming systems from the market after five years. Accordingly, the TGWG's proposed revisions remove the sunset language.

Additionally, submission under the grandfather provision was restricted to TGRAs and only provided grandfather status for games in active operation on the effective date. Accordingly, any manufacturer who may have had inactive games that would otherwise qualify for grandfather status, would not have been able to qualify such games for grandfather status. To ensure that tribes are able to take advantage of all Class II systems eligible for grandfather status, the TGWG has proposed a revision to this subpart.

Another substantive revision proposed by the TGWG concerns the inclusion of the provision requiring Underwriter's Laboratory testing of player interfaces in the existing regulation. Again, we note that we are unaware of any evidence that grandfathered Class II gaming systems pose a safety threat. Moreover, there is no support in IGRA for the proposition that the NIGC is authorized to establish or enforce electrical product safety standards, which is the province of other federal agencies, and, even if the NIGC had such authority, we question the propriety of an agency to specify a particular laboratory to conduct such product safety testing. Therefore, the TGWG proposed the removal of this provision. However, the TGWG does find it appropriate for the regulation to reflect that it is common industry practice for testing laboratories to make note or include other laboratory certifications as provided by the manufacturer in their report, hence language was inserted in the section concerning the content of laboratory reports.

Another issue with the existing rule is its restriction on tribal utilization of its own testing laboratory. The issue in this regard is not tribal ownership of testing labs, but rather one of independence and the appropriate segregation of function. In the view of the TGWG, it is not only unreasonable, but also imprudent to discourage tribes from developing greater capacity and utilizing it in this field given the sophistication of gaming technology. The proposed revision corrects this problem, while at the same time retaining provisions ensuring appropriate independence and segregation of function.

A major concern with regard to the existing regulation is the inclusion of a mathematical probability standard or "odds." In the existing rule the NIGC included an admittedly arbitrary probability standard that unfairly operates to limit game design and is not consistent with the probability standards applicable to most, if not all, charitable bingo operations and state lotteries. While the TGWG is of the view that it is appropriate to require Class II game manufacturers to disclose to TGRAs the mathematical expectations of the game and to have the laboratories verify such mathematical expectations, it does not view it appropriate for the NIGC to set arbitrary odds for bingo games. Accordingly, the TGWG offers a proposed revision to this subpart.

Another flaw in the existing regulation concerns provisions related to the "entertaining display" found on most Class II player interfaces. In Bingo gaming systems, game outcome is displayed on the bingo card located on the player interface which is independent of, and separate from, the entertaining display, which cannot in anyway affect the outcome of the game. Entertaining displays, therefore are irrelevant for regulatory purposes and operate solely to further the enjoyment of the player. Inclusion of regulatory language concerning entertaining displays

creates a false appearance of legal relevancy that significantly increases the potential for patron disputes. To correct this serious problem, the TGWG proposes the removal of this language.

Finally, the TGWG has proposed inclusion of a variance subpart, clarifying procedures and timeframes for the granting of a variance by tribal gaming regulatory authorities, including a mechanism for NIGC concurrence. This subpart is identical to the revision proposed in the TGWG's revised MICS. The TGWG is confident that the approach proposed captures both the tribal interest as the primary regulator of its gaming activities and the federal interest in providing regulatory oversight in a manner that is effective and efficient as well as timely.

In sum, TGWG has endeavored to propose revisions to Parts 543 and 547 that achieve a fair and balanced regulatory framework for Class II gaming.