

CUSTOMER FUNDS: UK REQUIREMENTS

The Gambling Commission recently stepped up protection for customer funds, with a formal monthly reporting mechanism due in 2015. Operators would be well advised to start planning with their finance teams to ensure full compliance, writes **Bahar Alaeddini** of Harris Hagan.

In order to gamble, customers open accounts with operators whereby they deposit monies or keep winnings, with the option to use those funds for future gambling or to withdraw at a later date. In recent years, there have been a number of high profile cases, the most notable being Full Tilt, where customer funds have been put at risk when operators have run into financial difficulties. These cases have highlighted that many customers misunderstand the level of protection offered to them, particularly in the event of insolvency.

As well as introducing new licence conditions on the issue in the past year, the Gambling Commission (GC) has increased the information available on its website to encourage customers to check what happens to their customer funds if an operator goes bust. Whilst the GC assesses the financial suitability of an operator when considering a licence application, there are limitations placed on its role, as it does not oversee the financial health and stability of an operator in real-time or on an on-going basis.

The GC has recently taken steps to provide customers gambling with GC-licensed operators greater protection by introducing:

1. *Segregation of customer funds*: Licence condition 4.1.1 requiring operators who hold customer funds to ensure they are held in a separate client bank account(s).

2. *Enhanced disclosure to customers*: Licence condition 4.2.1 requires operators to set out clearly in their terms and conditions

whether customer funds are protected in the event of insolvency, the level of such protection and the method by which this is achieved. This is supplemented by the GC's rating system, which must be provided in writing to each customer, in a manner which requires the customer to acknowledge receipt of the information and does not permit the customer to utilise the funds for gambling until they have done so, both on the first occasion on which the customer deposits funds and on the occasion of any subsequent deposit, which is the first since a change in the licensee's terms in relation to protection of such funds.

"Customer funds" is defined in the LCCP as the aggregate value of funds held to the credit of customers including, without limitation:

- a) cleared funds deposited with the licensee by customers to provide stakes in, or to meet participation fees in respect of, future gambling;
- b) winnings or prizes which the customer has chosen to leave on deposit with the licensee or for which the licensee has yet to account to the customer; and
- c) any crystallised but as yet unpaid loyalty or other bonuses, in each case irrespective of whether the licensee is a party to the gambling contract.

It is worth noting that funds from accounts which are dormant, as defined by the operator's terms and conditions,

are not considered customer funds and do not need to be included in the requirement to segregate customer funds, providing they were dormant at 1 November 2014. Accounts which were opened prior to 1 November 2014 and which become dormant thereafter are considered to be customer funds until the relevant charges have been applied and deducted from customer accounts.

Types of segregation

Customer funds may currently be segregated into: bank accounts (either in Great Britain or abroad), investment accounts or other accounts, such as, a payment processor/merchant reserve account. Operators using accounts which also hold funds relating to activity under another licence must be able to demonstrate to the GC that there are sufficient funds to meet all customer funds liabilities, including British and non-British customers. Investment accounts may be used providing a cautious approach is taken and operators have sufficient liquid assets to meet day to day customer payouts. Where payment processor accounts are used, operators must not exclude from their calculation funds in transit to customers and operators must not use accounts that would not be payable to the operator/its creditors in the event of insolvency; for example, where processing fees or chargebacks could still be deducted. Operators planning to use a payment processor merchant reserve account for segregating customer funds should carefully review the GC's guidance and examples.

The GC does not currently stipulate the manner in which customer funds are

segregated; however, in the future individual licence restrictions may be introduced as the GC considers appropriate. This may be achieved by way of a specific licence condition or an undertaking from the operator.

Levels of protection

The customer funds ratings categories – to be used by operators to identify their category:

1. BASIC: Segregation of customer funds

Customer funds are kept in accounts separate from business accounts but they would form part of the assets of the business in the event of insolvency. These accounts may include bank accounts, investment accounts and other accounts.

2. MEDIUM: Quistclose or equivalent

Customer funds are kept in accounts separate from business accounts; and arrangements have been made to ensure assets in the customer accounts are distributed to customers in the event of insolvency. The arrangements falling in the medium category include Quistclose accounts and insurance arrangements.

3. HIGH: Independent trust account

Customer funds are held in a trust account which is verified and subject to controls by an independent trustee.

Operators were required to amend their terms and conditions by 31 December 2014 to specify which category their protection falls into (basic, medium or high) and to explain why it falls into that category. It is a licence condition that any changes to the terms and conditions must be notified to customers before they come into effect. Further, by 2 February 2015, information must be made available at the point of a customer depositing money and acknowledged by the customer before

being allowed to deposit monies for the first time. Changes to these arrangements must also be similarly disclosed.

The GC's November 2014 Advice Note provides example statements that might be used in terms and conditions for each of the ratings categories, with the hope that over time standard wording may emerge. Whilst the GC has avoided prescribing the exact wording to be used, it has been reviewing licensees' published terms and conditions to check compliance, and contacting operators in breach.

Customer funds reporting

The May 2014 LCCP set out the requirement to report any deficit on reconciliation of a segregated customer funds accounts as a key event, a snapshot of customer funds information as part of an operator's quarterly regulatory return to the GC and compliance with the GC's customer funds reporting requirement as set out by the GC. In December 2014, the GC published a supplementary consultation document on the latter, which sought views on the exact format and timing of customer funds reports.

The GC has confirmed that during 2015 (no earlier than April) it plans to introduce a formal reporting mechanism, the 'customer funds report', to be incorporated into the GC's eServices system (also now used for regulatory returns and reporting key events), in order to monitor and ensure compliance with the GC's licence requirements and an operators' policies. The first report must be submitted within 14 days of the final day of the first reporting period. It is worth noting that this will not apply to operators, such as B2Bs, that do not hold customer funds, but such operators should contact the GC to confirm.

The GC proposes monthly reports for all

operators, which will be reviewed after an initial period of at least a year. Operators will be expected to carry out reconciliations on their customer funds and liabilities at least on a weekly basis (at any point during the week) and must report the amount of customer funds held in each of the relevant accounts including the location of those funds, the total funds held and the total customer liabilities at that time, the type of reconciliation, and distinguish between funds relating to the GC licence and other customers funds (British and non-British customers). If a report shows a deficit (a key event), the operator will be expected to provide reasons to the GC and provide confirmation of when the funds will be in place to cover the recorded liabilities.

Each customer funds report must be verified by a PML holder in a key position.

At this stage, the GC has confirmed that supporting documentation, such as account statements, will not be required with each monthly report; however, there may be instances where further information is requested from the operator.

Whilst the GC has not published a full timeframe for implementation, which is likely to be set out in its consultation response document, operators are strongly encouraged to familiarise themselves with the December 2014 consultation document and start planning with their finance teams to ensure full compliance.

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