

## Executive Summary

Legislation (SF 438) was enacted and signed in April 2015 directing the Iowa Racing and Gaming Commission (IRGC) to study the topic of exchange wagering and report the findings to the Iowa Legislature by December 1, 2015. The intent of the report is to provide policy-makers with information so they are able to make an informed decision concerning the possible authorization of exchange wagering.

It is important to understand some key industry terms when discussing exchange wagering. *Exchange wagering*, as defined by SF 438, is a form of wagering in which two or more persons place identically opposing wagers in a given market. It allows customers to wager on both winning and non-winning outcomes in the same event so long as customers are willing to accept the odds offered by each side of the outcome. *Pari-mutuel wagering*, as defined in Iowa law, means the system of wagering as described in 99D.11. In practice, pari-mutuel wagering is a betting system that creates a pool of money based on possible winning outcomes at a racetrack. The racetrack takes a fee (or takeout) of the pool and distributes the remaining money in the pool to winners based on a proportion of their wagers. *Advanced deposit wagering (ADW)*, as defined in 491 IAC 8.1, is a method of pari-mutuel wagering in which an individual may establish an account, deposit money into the account, and use the account balance to pay for pari-mutuel wagering. ADW takes place over the internet using a computer or mobile device. Exchange wagering would likely take place on an ADW platform.

The report considered the current state of exchange wagering by surveying industry participants who are familiar with the subject, by reviewing current events in New Jersey and California where exchange wagering is legal but not operating, and by researching foreign jurisdictions where exchange wagering is legal. The current state of pari-mutuel wagering in Iowa was discussed as part of this report in an effort to understand the history of pari-mutuel wagering in Iowa, in addition to considering the successes and challenges related to pari-mutuel wagering in Iowa. The potential revenue impact of authorizing exchange wagering was reviewed in an effort to understand if or how much of an impact the potential addition of exchange wagering will have on purses (total amount of money paid out to the owners of a racing animal), operator's revenue, and taxes for the State of Iowa. Lastly, extensive research was conducted and reported in the area of consumer protection, including but not limited to, identity and age verification, network security, auditing of wagering software, race integrity and making 'lay' and in-play wagers, and licensing of entities participating in the industry.

Exchange wagering occurs in many European countries and Australia on web-based betting exchanges. The exchanges exist for consumers to place wagers at the prices and odds of the consumer's choice with an identically opposing wager needed to match the wager in a given market. Web-based betting exchange operators use technology to match supply and demand wagers on a wide range of activities including horse racing, sports markets, and entertainment. A valid matched wager is formed when two or more persons are confirmed by the exchange operator as having identically opposing wagers in a given market. A web-based exchange provides consumers a unique wagering opportunity as compared to traditional methods of wagering.

In the United States, exchange wagering is statutorily authorized in California and New Jersey for pari-mutuel horse racing only. New Jersey has set forth rules and regulations for exchange wagering at Monmouth Park and the Meadowlands Racetrack facilities. One online betting exchange, Betfair, is currently undergoing New Jersey's licensing process to operate the first web-based exchange wagering platform. California's exchange wagering is currently on hold due to disagreements between stakeholders in the horse racing industry. Although statutorily authorized, neither jurisdiction has yet to accept an exchange wager.

In 1983, the Iowa Legislature passed the Pari-Mutuel Wagering Act allowing for qualifying organizations to apply for a license to conduct pari-mutuel wagering on horse and dog racing. In 1984, four facilities were issued licenses. The four licensees were the Racing Association of Central Iowa (Prairie Meadows), National Cattle Congress (Waterloo Greyhound Park), Dubuque Racing Association Ltd (Dubuque Greyhound Park), and the Iowa West Racing Association (Bluffs Run). In 1989 simulcasting, the telecasting of live audio and visual signals of pari-mutuel races received from an authorized racing facility for the purpose of pari-mutuel wagering was enacted.

The early 90's brought difficult times for pari-mutuel racing operations in Iowa due to some decline in wagering caused by competition from racing and casino gambling in adjacent states resulting in Prairie Meadows and Waterloo Greyhound Park filing for bankruptcy. In March 1994, the Iowa Legislature enacted legislation to allow racetrack enclosures existing in January 1994 to allow certain gambling games if approved by local referendum. As a result, racinos, racetrack facilities with gambling games, came into existence at Dubuque Greyhound Park, Bluffs Run, and Prairie Meadows. This increased profits, allowed for debt repayment,

charitable contributions, and the funding of community projects. The racino concept in Iowa has been a model used throughout the United States due to its success. In 2011, ADW was approved at Prairie Meadows and implemented in 2012. Legislation was enacted in 2014 allowing for Dubuque Greyhound Park and Bluffs Run to continue to offer casino gaming without the requirement to conduct live greyhound racing. Dubuque Greyhound Park ended live greyhound racing in 2014. Bluffs Run will end greyhound racing in December of 2015. Also pursuant to the 2014 legislation, a license was issued in 2015 to the Iowa Greyhound Association to conduct live greyhound racing in Dubuque without casino gaming.

The live racing handle (total amount of money wagered) and simulcast wagering at the licensed racetrack facilities started strong when operations began. A gradual downward trend has continued to date for the live track handle and simulcast export (wagering on simulcast signals sent by Iowa racetracks). Simulcast import wagering (wagering on simulcast signals received at Iowa racetracks) had its highest handles in Iowa in the early 1990's. Following this period of time, simulcast import wagering began a downward trend which continues to date.

Revenues from exchange wagering are generated in a different manner than traditional pari-mutuel wagering. With exchange wagering, a commission is charged on either the net winnings or bet winnings of the customer depending on how the operator or jurisdiction elects to charge a customer. A net winnings model, where a commission is charged on the customers overall winnings from the market or pool, encourages greater liquidity for the exchange. However, it would likely generate lower overall revenues compared to a bet winnings model where commissions are charged on each winning back and lay wager within the race. There also is debate in the industry whether exchange wagering will grow overall wagering revenues.

Some people in the industry believe the commissions charged for exchange wagering are far less than the take out of pari-mutuel wagers. Concerns are customers will shift their spending to lower revenue generating exchange wagers resulting in a possible decline of overall revenues. Others in the industry believe exchange wagering will attract new customers to horse racing, therefore any cannibalization of higher revenue generating wagers would be replaced and exceeded from this new customer base.

There is no precedent for exchange wagering in the United States to assist with projecting revenues in Iowa. In addition, the stakeholders interviewed for this report did not offer any opinions with respect to projecting revenue. IRGC staff prepared a model, making a number of assumptions identified in the report, which demonstrates how revenues correlated to mutuel handle. The model may assist policy-makers in understanding the different stakeholders that would receive revenues from exchange wagering and how much would reasonably flow to horse racing purses and track operator revenues in Iowa depending on the amount of handle received from exchange wagering. IRGC staff believes the model is a reasonable representation of what can be expected, however this representation should be considered for what it is; a representation based on a number of assumptions with no precedent to directly rely upon.

It is also unclear if the State of Iowa will receive tax revenues as a result of adding exchange wagering to the current wagering options at Prairie Meadows. Iowa Code 99D.15 currently calls for a tax of six percent on the gross sum wagered by the pari-mutuel method, and further allows for a tax credit of six percent if the gross sum wagered is below \$90 million in one year. Tax implications for Iowa, with respect to exchange wagering, are unclear due to the following reasons: 1) revenue for exchange wagering is based on net or bet winnings and not

gross sum wagered, 2) the belief that exchange wagering is different than pari-mutuel wagering, 3) it is difficult to project if enough wagering will occur for Prairie Meadows to exceed the \$90 million amount that allows for a credit of taxes paid. IRGC recommends if exchange wagering is authorized in Iowa, Iowa Code 99D.15 should be amended to clarify if or how exchange wagering would factor into the pari-mutuel tax.

Consumer protection was researched and the development of licensing standards for companies and individuals participating in the gambling operations will be an important part of the regulation for exchange wagering. IRGC staff should conduct suitability checks on participating companies and their key employees. Background investigations should include criminal and financial reviews to ensure the public the exchange operator is qualified to receive a license in Iowa.

IRGC staff has previously worked with industry participants to develop uniform standards that relate to the prevention of problem gambling. Prevention of underage gambling, as well as the ability for problem gamblers to limit or withdraw themselves from gaming activity, is included in these standards. Research has indicated that in an online environment, many companies do have technology that can help in age and personal identification. IRGC should require the exchange operator to have software in place to ensure the exchange functions as designed in regards to determining age and personal identification of people wagering on the exchange.

Wagering via the internet does bring to the forefront concerns regarding identity theft, financial account security, and money laundering. In the past, IRGC has contracted with GLI and BMM to provide independent testing and verification of various software and hardware

components involved with slot machine and table game operations. IRGC should again utilize GLI, BMM, or other independent companies to ensure the exchange operator has quality control processes and products in place that can detect the aforementioned activity and limit or stop it completely.

A unique aspect of exchange wagering and subsequent concern of the public is the potential of possible manipulation in a race. ‘Lay’ betting (betting a horse to lose) is a new idea and an integral part of exchange wagering. One potential way to address this concern is to limit who can place lay bets. The regulatory authority can enact rules prohibiting any licensee who has a direct connection to a horse from making lay wagers. A review of regulatory rules in California and New Jersey show a list of licensees that could be restricted from making lay wagers including: jockey or the rider of a horse, trainer/assistant trainer, veterinarian, valet or stable employee, owner of horse, or anyone directly associated with these groups who may have knowledge of a horse’s condition that isn’t known to the public. This specific concern is equivalent to insider trading in the stock exchange. Another aspect of exchange wagering is allowing in-play wagering which is making wagers after the start of a race and before the race has been declared official. This option allows bettors the opportunity to hedge previous bets based on real time information at new market odds that are updated continuously. IRGC’s research has noted a concern with in-play wagering, specifically that delays in receiving video feeds could cause some advantage to players with real-time or quicker transmissions of video. An additional concern could be the use of gambling bots. Gambling bots are software which can be used on the gambling exchange to help speed up the process of evaluating information and placing subsequent wagers.

The research conducted by IRGC staff revealed some areas where information was difficult to obtain or seemed to be contradictory. Specifically, IRGC staff discovered conflicting answers as to how much or which segments of the horse racing industry will benefit from exchange wagering. This is best demonstrated by the varying positions of policy-makers in the two states where exchange wagering is legal in the United States (California and New Jersey). It should also be noted the revenue projections used in this report included a number of assumptions in an effort to provide some guideline for how increased handle translates to income. It would be beneficial to further study these assumptions along with receiving additional information on the topic of revenue.

Further information on the topic of in-play wagering and automated wagering software may also be needed as both topics, at the projected volume utilized in exchange wagering, would be new to industry participants in Iowa and many gambling jurisdictions across the United States. In-play wagering produces additional wagering opportunities for customers that are not offered in traditional pari-mutuel wagering. These wagers may generate additional interest and revenue; however it is possible to gain an advantage viewing races live versus having some delay via a simulcast link. Automated wagering software is something that is encouraged in exchange wagering to keep pools liquid. This is something that appears to be common in stock and commodity trading and could bring high interest and revenues for those not currently participating in pari-mutuel wagering. Additional thought and research may be needed to understand how automated software interacts with the exchange wagering system to ensure all customers are receiving similar access.

As stated earlier, the concept of exchange wagering is totally new to markets in the United States. As of the publishing of this report, no jurisdiction in the United States has actually implemented the concept of exchange wagering. Much of IRGC's research is based on interviews of potential participants that may emerge in future gambling markets. Since there is little or no historical data, many of the conclusions drawn are "best guesses" and may or may not come to fruition. IRGC staff will keep abreast of current and future events and continue to monitor the landscape in the United States as it relates to exchange wagering. When exchange wagering goes live in New Jersey, this will give all stakeholders an opportunity to look at true data and re-evaluate previous conclusions and update them as necessary.