

BRITISH HORSERACING BOARD

MEMORANDUM TO THE JOINT COMMITTEE

ON THE DRAFT GAMBLING BILL

December 2003

Introduction

1. The British Horseracing Board (BHB) is the Governing Authority for British Racing, a major sport and industry which, together with the Betting Industry, employs 100,000 people directly and indirectly; generates £400m annually for the Exchequer through betting duty and other taxes; and is a major contributor to the rural economy, primarily via the breeding industry.
2. British Racing is heavily reliant for its financial health and stability on revenue from the betting industry, whose use of the high quality racing product and the pre-race data associated therewith, is paid for, currently, through the statutory horserace betting levy and, in future, following the abolition of the Horserace Betting Levy Board, through commercial licensing arrangements. In 2003/04 the horserace betting levy (including contributions from the Tote) is expected to generate over £90m.
3. British Racing has therefore a strong interest in legislation which could have a significant impact on its future integrity and funding. It is BHB's view that without appropriate legislation, betting exchanges represent a significant threat to both.

Overview

4. BHB has welcomed the thrust of the Report of the Gambling Review Body (GRB) and the Government's response, "Safe Bet for Success". In particular it welcomed the emphasis on consumer protection, keeping gambling crime-free and protection of the vulnerable, as reflected in the intention to establish a Gambling Commission with wide ranging powers of licensing, enforcement and prosecution.
5. However, when responding to Government on the GRB Report in October 2001, BHB stated: "BHB is deeply concerned about the recommended significant deregulation of all aspects of gambling. While not afraid of competition in the overall gambling market, Racing opposes deregulation on the scale recommended without commensurate measures and opportunities of direct benefit to horserace betting, notably the widening of the distribution of the product betting, under properly controlled conditions, in pubs and clubs".
6. This general concern remains. Indeed, already over the last two years, competition with Racing for punters' interest in licenced outlets has greatly increased, both in terms of intensively promoted higher margin products and also low margin casino games, made practicable by the change in the tax regime. Whilst the move to gross profits benefited bookmakers, who are now enjoying exceptional levels of profitability, which are beyond expectations, the change produced income for Racing which was more than 20% below expectations.
7. It is BHB's view that the principal cause of this shortfall is the impact of Betting Exchanges, made more acute by the impact of the favourable tax treatment they and their users receive when compared to traditional bookmakers.

Scope of Written Evidence to the Committee

8. In submitting this short Memorandum, BHB focuses on two key areas to which the Committee have indicated that they propose to direct particular attention together with necessary transitional arrangements;
 - a) the *regulation* of betting exchanges in the light of the Committee's indication that it will address the ability to regulate them effectively and their impact on the rest of the Betting Industry, particularly bookmakers;
 - b) the *taxation* of betting exchanges in the light of the Committee's indication that it will address "how the proposed deregulation will fit with the existing tax regime for different aspects of gambling".

Comments on other aspects of the Draft Bill will be made direct to DCMS in the context of that Department's own consultation exercise which concludes at the end of February 2004. The narrow scope of this Memorandum should not be taken to imply that BHB does not believe that the Committee should take the opportunity to consider the horserace betting market, and in particular issues relating to integrity, more generally, in its review. BHB believes that it would be inappropriate for the Committee to consider issues relating to integrity only in the context of betting exchanges without considering the market as a whole.

Transitional Arrangements

9. BHB recognises that the changes associated with the Draft Gambling Bill will not be fully implemented until that Bill passes into law. This means that, while the precise timetable is unknown, there will be no formal action for at least a further year and probably longer.
10. In these circumstances BHB welcomes the proposal to designate the current Gaming Board as the Shadow Commission and urges the Committee to encourage the Government to move ahead as swiftly as possible with the introduction and passage of the legislation, and in the meantime to invite the Gaming Board to make as much progress towards implementation of the proposals as circumstances will allow.
11. It is BHB's view that the threat to the integrity of the sport from betting exchanges and their abuse means that the Shadow Commission must be as robust as it can be in requiring that betting operations observe the intent of the legislation on a voluntary basis prior to its formal introduction.

Summary of Conclusions

12. Betting exchanges, fuelled by the change to gross profits tax, have grown at a phenomenal rate over the last two years to the point where BHB estimate that they will soon match £6bn of stakes (matched stakes) on an annualised basis, operating on an international stage.
13. Betting exchanges create the possibility that any unlicensed person can make substantial profits by the laying of a horse to lose and that an unlicensed bookmaker can make substantial profits without paying the appropriate amount of tax or levy or to Racing.
14. The scale and international nature of betting exchanges represent an unprecedented and substantial threat to the integrity of Racing, which lies at the heart of the racing product, as the number of reports of alleged irregular betting patterns, focussed on losing horses, accelerate on an almost daily basis.
15. The regulator of the Sport, the Jockey Club, can, to a degree limited by voluntary behaviour, monitor the use and abuse of betting exchanges but is powerless unless adequate sanction is created by statute in the hands of the Gambling Commission.
16. The taxation of betting exchanges creates an unlevel playing field which distorts the market, gives betting exchanges an unfair advantage and results in less money flowing to Government and to Racing.
17. The use of betting exchanges by bookmakers to arbitrage market prices results in lower margins for the betting market overall which results in less money flowing to Government and to Racing.

Summary of Recommendations

18. Recreational layers on a Betting Exchange should be distinguished from non recreational layers by the volume of their laying over a specified time period whereby non recreational layers would be deemed to be in the business of betting and would require an appropriate licence, awarded on the basis of a "fit and proper" test.
19. The Gambling Commission should be given powers of investigation and audit to uncover abuse.
20. The Gambling Commission should be given sufficient powers of sanction to deter wrong-doing including, but not necessarily limited to, the withdrawal of licences from non recreational users.
21. The scope of taxation of betting exchanges should be widened to include the taxation of individual layer's profits to ensure a level playing field, eliminate market distortions and that betting exchanges and their users make an appropriate revenue return to Government.

Regulation of Betting Exchanges

Gambling Review Body Report and the growth of Betting Exchanges

22. The Committee's particular scrutiny of the regulation of betting exchanges is not only welcome but necessary given that, as betting exchanges were only in their infancy when the GRB was sitting in 2000/01, the GRB did not subject Exchanges to the same rigorous independent scrutiny as it applied to all other aspects of gambling. Betting exchanges ("Betting Brokers") were addressed in two short

paragraphs in the GRB's Report (19.41 and 19.42) which recommended only that "betting brokers should be licensed and regulated in the same way as bookmakers".

23. The growth in betting exchanges and their use since the GRB reported has been unprecedented and could not have been forecasted. On their own measure of turnover (matched stakes) and corroborated by our own estimation, it is likely that the turnover of betting exchanges will soon exceed £6bn per annum.

The Threat to Racing's Integrity

24. BHB is very concerned about the threat which betting exchanges pose to the integrity of Racing. This threat principally arises from the fact that, for the first time ever, unlicensed individuals have ready access to operations which allow them not only to back horses but also, crucially, to lay them. This means that countless, anonymous individuals, both in this country and overseas, can readily lay horses to lose. In the past this has been a facility effectively restricted to bookmakers themselves and professional gamblers and their broad equivalents.
25. This incentive to win money on a losing horse represents an unprecedented threat both to the integrity of racing and even more particularly to its reputation, as the regular coverage of races which are regarded as suspect, in some way, well demonstrates. In the absence of a rigorous scheme of regulation both by the Jockey Club and, more importantly, by statute, the continued suspicion generated by these stories is, and will continue to have, a debilitating effect on the good name of British horseracing, carefully built up over many years, particularly as punters now have many alternative betting opportunities. In the BHB's view this calls for particularly rigorous scrutiny, regulation and policing of this very real threat.
26. The challenges of policing worldwide operations of this scope and complexity should not be underestimated. Nor should the difficulties of securing convictions in the event of malpractice. Sports regulators, with inevitably limited resources, cannot reasonably be expected to have the ability to deal with this very significant integrity threat, even with the enhanced regulatory arrangements which the Gambling Commission will introduce. The threat can only be adequately dealt with by statutory powers and sanctions.
27. As further reinforcement of the view that rigorous policing is required, the Committee should be aware that Racefax, an independent monitoring service, identified over 170 instances of irregular betting patterns on betting exchanges in the year to October 2003. Racefax employ a filtering system to reduce the very much greater number of races where there is a substantial drift in price, which incorporates the degree of underperformance by a horse against its BHB rating and unusual riding tactics. Details can be made available to the Committee in confidence on request. The fact that many horses whose price drifts do go on to win, as has always been the case, does not mitigate the main concern, namely an apparent sharp increase in the volume of otherwise fancied horses which drift in price and lose and whose unusual running may indicate that there is an irregularity. The fact that some of these instances may have innocent explanations does not stop the questions they raise damaging Racing's reputation for integrity: hence the obvious need for adequate responses.
28. The Committee should also be aware that a number of foreign racing jurisdictions, after careful and due consideration, including Australia, Hong Kong and Japan, are refusing to licence betting exchanges because of both the integrity threat and their likely impact on the revenue stream on which they also depend.

The Proposed Legislation

29. BHB recognises that the Draft Gambling Bill is constructed on the basis that a Gambling Commission will be established with wide ranging powers of investigation and responsibility for issuing operating licences to various classes of betting operator. This includes a "Betting Intermediary Operating Licence" (Clause 51(2)e) for betting exchanges, to which a number of mandatory conditions will be attached, as they will to all other operating licences, and to which the Commission will be given the power to attach additional conditions which are specific to the activity.
30. As far as Racing is concerned, it is important that the Gambling Commission and the sport's Regulator, the Jockey Club, work closely together, exchanging intelligence and as much hard evidence as possible to substantiate inquiries/prosecutions when malpractice is evident and to make appropriate arrangements for warning and watching closely particular participants. BHB acknowledges, as does the Jockey Club itself, that the Regulatory Authority for Horseracing, has a key responsibility for monitoring and investigating where appropriate, but is firmly of the view that this activity could only be effective if information is exchanged on a timely basis between the Commission and the Regulator. It is vital

therefore that the Gambling Commission is given the maximum reasonable powers to complement the determined efforts which the Regulatory Authority of any sport on which betting is conducted through Exchanges will need to make to deal with abuse.

31. These powers must incorporate those of investigation as well as the application of appropriate sanctions. The regulatory authority can legitimately monitor the use and abuse of betting exchanges but unless there are powerful sanctions against abuse which can only be properly applied by statute, it is BHB's view that monitoring (or indeed regulation) on its own would have little or no impact and the integrity of the sport would continue to be under serious threat.
32. The Committee should note that there will be a high cost in the proper monitoring of the high volume of daily transactions on betting exchanges to determine whether or not there has been irregular betting activity and subsequent investigation. This cost will be much higher not least because betting exchanges operate on a world wide basis. This significantly higher cost will have to be borne out of the higher price which BHB believes betting exchanges should pay to racing.,
33. In these circumstances, BHB recommends that the Committee should satisfy itself that the interface between the Gambling Commission and Sports Regulators generally is adequate to deal with any integrity threat arising from betting operations, a system of all types. In the context of betting exchanges, consideration should be given to establishing, on a practicable and policeable basis under which "recreational" layers on exchanges do not require a licence but "non-recreational" layers, who are in effect deemed to be in the business of bookmaking, do require an appropriate licence, only awarded after application of "fit and proper" tests. Backing would be unaffected. The two types of layer might reasonably be differentiated by the establishment of a threshold relating either to the amount of betting or to the number of transactions over a given period, above which a layer is deemed to be "non-recreational".
34. This treatment would not capture the vast majority of betting exchange users for whom the use of a betting exchange is truly recreational. BHB recognises that this has been a major concern of HM Customs & Excise. The treatment applies appropriate "fit and proper" tests and incorporates sanction in the form of removal of the licence.
35. The treatment may also capture a few large recreational layers who are not in the business of bookmaking. These are likely to be few and the inconvenience caused to them would appear to be a very small cost indeed for the associated benefits to the integrity of the sport in the regulation and policing of betting exchanges and their users and the very great threat they would otherwise pose.
36. The question of how the threshold would work in practice and at what level can only be properly addressed in consultation with all relevant parties and on the basis of a detailed analysis of relevant statistics.

Taxation of Betting Exchanges

37. In BHB's view, betting exchanges are not currently on a level fiscal playing field, as far as taxation is concerned. Last summer BHB supported amendments to the Finance Bill, tabled by George Howarth, which were regrettably unsuccessful, although the dialogue between the Betting Industry, Racing and HM Customs & Excise continues. This has the direct impact of lowering taxation revenues for government. This lowering is exacerbated by the ability of the on-course market, in effect acting as a recreational player, either by themselves or through intermediaries, to take advantage of the lower cost of using a betting exchange facilitated by an inequitable tax base to arbitrage prices into betting exchanges. This has the consequence of inflating starting prices and lowering margins in the market generally so that tax revenues are reduced further still. The current situation, where layers on a betting exchange do not have to obtain a bookmaker's permit, make it difficult if not impossible to distinguish between a bookmaker and a recreational user, facilitating this type of arbitrage.
38. It is BHB's view that Government has the right to ensure that gambling organisations and their operations pay adequately to society as a whole for the licence to conduct bookmaking businesses, which Government grants them. An unlevel taxation playing field, as well as being inherently unfair and creating a market distortion, means that betting exchanges and their users are not paying an appropriate contribution to social policy as others are doing.
39. In BHB's view, betting exchanges should be taxed on the basis of individual (disaggregated) layers' profits in addition to the current system of taxing the betting exchanges commission. Such a system would recognise that there are two economic transactions underlying the use of a betting exchange, both of which result from betting, both of which should be subject to gross profits tax. The first transaction is

between the betting exchange and its customer and the second is between two betting exchange customers. The Committee is urged, in the context of assessing the relationship between the proposed deregulation and the current existing regime for different aspects of gambling, to consider the equity of the current taxation basis.

40. The taxation basis should therefore be reviewed as a matter of urgency. In parallel with this, BHB is reviewing its own commercial policy vis a vis the licensing of betting exchanges to use BHB's pre-race data. This review has, in part, been prompted by the £20m shortfall in the yield from the 41st Levy Scheme 2002/03, which BHB and bookmakers largely attribute to the impact of exchanges on betting margins on course.
41. If the Industry's income continues to be impacted in this way, without a reasonable level of return from the massive and growing Exchanges turnover, the National sport of Racing, which has received so much encouragement and support from the Government and Parliamentarians, will continue to suffer from what amounts to a sharply tilted playing field. The Committee is asked to examine thoroughly the fiscal/financial situation and to come to a view which takes due account of both the need for betting exchanges to contribute adequately to Racing and to the Exchequer and to operate in a way which does not negatively impact the activities of traditional bookmakers and the contribution which they make to the Industry and Government.

Jockey Club Evidence

42. In its capacity as Regulatory Authority of British Racing, the Jockey Club has also submitted written evidence to the Committee. In that evidence the Jockey Club has, inter alia, proposed a number of conditions which should be attached to operating licences for betting organisations; drawn attention to the steps already taken by the Club to mitigate the threat which betting exchanges pose to the integrity of racing; and expressed strong support for a "partnership approach" between the Jockey Club and the Gambling Commission if effective regulation of horseracing and betting thereon is to be achieved. In the latter context, the Jockey Club state that "the most effective deterrent to malpractice will be successful prosecution of offences, either by the Gambling Commission in the case of criminal offences or by the Jockey Club in cases of breaches of the Rules of Racing".
43. The Committee will therefore note that the fundamental concerns and proposals expressed by both the Governing Authority and the Regulatory Authority for Racing are consistent not only with each other, but with the Government's own recognition that enhanced statutory controls and powers are an essential complement to rigorous regulation by sports regulators themselves, whose heavy responsibility in these matters is universally acknowledged.

Conclusion

44. BHB has no wish to prohibit the punter from accessing betting operations which are innovative and provide them with value. However, in the context of considering the regulation of betting exchanges, it must be remembered that the punter only participates in British horserace betting on the basis that it has very high standards of integrity. It is in the punter's interests therefore that everything possible is done by the Government, the Gambling Commission and the Regulator to minimise threats to integrity and to introduce a regulatory and policing regime which balances punter choice and integrity protection.
45. The rate of growth of betting exchanges has no parallel. It is likely that they will produce annual turnover, as they themselves measure it, of over £6bn. While the operation and effect of betting exchanges may have already been considered by Government Departments over the last two years, this unprecedented rate of growth and the threat to the sport which would be caused by weak regulation mean that their operation, regulation and taxation should be reviewed afresh. BHB welcomes the Committee's clear intention to do just this.