



28 April 2009

Gambling Inquiry
Productivity Commission
Locked Bag 2
Collins Street
East Melbourne VIC 8003

Gambling Inquiry – Submission by Racing NSW

Introduction

Racing NSW is a body corporate created by statute (NSW Thoroughbred Racing Act 1996) to control and regulate the NSW Thoroughbred Racing Industry.

In addition, Racing NSW is a member of the Australian Racing Board (ARB), the body responsible for the coordination of matters of national interest and the implementation of national rules of racing.

The ARB has lodged a submission with the Commission in respect of the Gambling Inquiry and, as a member of that body, Racing NSW supports the general theme of that submission. (It does however have some reservation as to the views put forward on behalf of Racing Victoria in respect of its analysis of wagering income scenarios).

At the same time however, Racing NSW does wish to put forward a separate submission for the Commission's consideration.

In doing so I would point out that in mid 2008, Racing NSW lodged a submission with an independent inquiry into wagering regulation established by the NSW Government (The Cameron Inquiry). So as to support its submission to that Inquiry Racing NSW commissioned the Boston Consulting Group (BCG) to undertake an independent review of the issues outlined in the terms of reference for the Cameron Inquiry.

As many of the issues covered in the Cameron Inquiry fall within the terms of reference of the Commission's current inquiry, I have attached for the Commission's information a copy of Racing NSW's submission to the Cameron Inquiry and a copy of the BCG report.

Recommendations

It is recommended that the Productivity Commission:

- support the implementation of a national approach to the application of Race Field Legislation, particularly in respect of ensuring the constitutionality

1

surrounding the application of race field fees and putting beyond doubt the ability of a State racing controlling body to apply fees in a manner best suited to its particular circumstances.

- support the introduction of legislation to amend the Interactive Gambling Act 2001(Cth) to prohibit the offering of totalizator odds betting by persons other than licensed totalizator operators and unless that operator is actually conducting a totalizator. In other words unless a wagering operator is licensed to conduct a totalizator, that operator should be compelled to offer a fixed price about a runner at the time the operator accepts a bet from a punter and payments should only be based on bookmaker odds with returns being known prior to the start of a race.
- support amendments to the Inter-Active Gambling Act 2001 to provide for the reinstatement of prohibitions which prevent overseas operators from providing wagering services to Australian residents and also introducing legislation making it an offence for an Australian licensed financial institution to process deposits and withdrawals between Australian punters and overseas wagering operators. These prohibitions should be complemented with significant penalties including monetary fines and criminal sanctions so as to ensure compliance with the legislation.

Background

The NSW Thoroughbred Racing Industry

The NSW thoroughbred racing industry is a major contributor to the NSW economy and employment with approximately 50,000 participants, providing the equivalent of full time employment for more than 16,000 people.

The scale and breadth of the NSW thoroughbred industry and its contribution to NSW have been consistently verified in numerous independent reviews.

NSW has one of the world's largest thoroughbred racing industries. The size of the NSW racing industry combined with the vast geographic area which the industry covers is virtually without parallel in racing anywhere else in the world.

Racing is a particularly important part of the economic and social fabric of many NSW rural and regional centres, with the annual racing carnival being a major social event for many small rural communities which in turn provides the labour and financial support for that annual race meeting.

To a large extent the continued viability of the racing industry in NSW and the financial welfare of its thousands of participants rely on a combination of net contributions by racehorse owners and revenue received from persons wagering on the racing product.

In respect of owners' contributions, it has been estimated that even without taking the initial capital outlay into account, racehorse owners in New South Wales incur

annual training and upkeep costs of \$200 million which is \$113 million in excess of the prizemoney returns they receive. Any increases in this financial impost will cause a significant exodus of owners from the industry.

In respect of wagering revenue, the traditional model for wagering in Australia up until the late 1990's was a combination of totalizator and bookmaker operations on the racecourse and totalizator operations off the racecourse. This model served the industry well and allowed the industry to return up to 60% of training and racing costs to owners in the form of prizemoney compared to a maximum of 30% of costs returned to owners in Ireland, Germany and Great Britain where the wagering landscape is dominated by bookmakers and betting exchanges conducting low margin operations.

At appendix (1) is a schedule which provides a detailed analysis of the returns to racehorse owners in various racing jurisdictions throughout the world on the basis of the principal model of wagering/funding adopted in that country.

In New South Wales, it has been calculated that, over the five years to 30 June 2007, funding of the NSW thoroughbred racing industry from wagering operators has declined in real terms at a compound annual rate of 0.5% p.a., while costs for participants have continued to rise.

As a result the NSW thoroughbred racing industry is significantly under-funded. Its principle source of revenue, fees from NSW TAB under the Racing Distribution Agreement ("RDA") which provide approximately 70% of the industry's revenue, has declined in real terms over the decade since the privatization of the NSW TAB.

This decline has been driven by the significant changes in the competitive and regulatory environment for wagering in Australia over the last decade, in particular the growth of internet and telephone betting by wagering operators (particularly corporate bookmaking firms) licensed in States or Territories with favorable regulatory and tax regimes. Those changes have for practical purposes eliminated the "exclusive access" which wagering operators licensed in a particular State or Territory had to wagering customers located in that State or Territory which existed until the 1990s and which is still implicit in much of the NSW regulatory regime applicable to wagering.

As mentioned, these changes in the competitive and regulatory environment have given rise to three clearly discernable trends:

- Firstly, there has been a decline in the dominance of totalizator wagering relative to other forms of wagering.
- Secondly, wagering operators licensed in NSW have fallen behind, as NSW customers increasingly bet with wagering operators licensed in other States and Territories who, by virtue of more favorable tax and regulatory regimes, are able to provide more attractive product, pricing and service offerings.

- Thirdly, a significant increase in the proportion of total wagering on NSW thoroughbred racing being conducted by interstate wagering operators who have been able to commercially exploit NSW racing for their own benefit without paying anything to the NSW racing industry – essentially “free riding” on the resources, time, effort and money invested by NSW racing industry participants to conduct and promote the racing events. To allow such “free-riding” is inconsistent with economic principles, competition policy and sound market practice.

As a result of these changes the growth in totalizator betting has declined considerably compared with betting with bookmakers, particularly the Northern Territory based corporate bookmakers.

This decline is illustrated by the following table.

Period	Compound Average Growth in Turnover		
	Totalizators		Bookmakers
	NSW Only	All Australia	All Australia
1987 -2000	4.5%	5.0%	-6.2%
2001 - 2006	1.7%	3.4%	19.4%

Regulation of Wagering

As is the case with racing, wagering has traditionally been regulated on a state by state basis and as wagering has developed into a borderless operation, the ability of State Governments and State racing industries to keep pace with that development has not been possible.

There are three issues which we believe are beyond the ability of individual States to regulate effectively and we would ask that they be addressed by the Commission on a national basis. They are:

- Race Field Legislation
- Tote Odds betting
- Overseas wagering operators

Race Field Legislation

The recent “race fields” amendments to the *Racing Administration Act 1998 (NSW)* (“NSW race fields legislation”) which commenced on 1 July 2008 require any person, including a wagering operator, who wishes to publish a NSW race field to obtain the approval of the controlling body of the relevant racing code in NSW and

permit the relevant controlling body to impose conditions on that approval in relation to the payment of fees and other matters to protect the integrity of racing. (On 3 December 2008, amendments to the Racing Administration Act 2008 came into effect which essentially replaced the previous term **Publish** Race Fields Information with the term **Use** of Race Fields Information. The amendments were introduced in order to close a technical loophole that some wagering operators were using to avoid being subject to that legislation).

This is a major development as, in the absence of such legislation or other legislative requirements such as that applicable to NSW totalizator operators under section 21A and 43(2) of the Totalizator Act, wagering operators have been able to commercially exploit NSW racing for their own benefit without paying anything to the NSW racing industry – essentially “free riding” on the resources, time, effort and money invested by NSW racing industry participants to conduct and promote the racing events. To allow such “free-riding” is inconsistent with economic principles, competition policy and sound market practice.

The NSW Race Fields Legislation was designed to address two key policy objectives:

- Firstly, that wagering operators who commercially exploit NSW racing events for wagering purposes should be required to pay fees to the controlling body of the relevant racing code in NSW which that controlling body can then apply to provide the necessary financial returns to the industry participants; and
- Secondly, that the wagering operator must have arrangements with each controlling body of the racing or sporting code on which they conduct wagering which enable the controlling body to obtain access to wagering data and betting information to enable the controlling body to protect the integrity and reputation of the underlying sport.

In accordance with the discretion afforded it under the legislation, Racing NSW has determined that it will charge the same rate of fees – 1.5% of turnover – to all Australian wagering operators regardless of where they are licensed or what type of betting they offer, but will not charge fees on the first \$5 million p.a. of a wagering operator’s turnover on NSW thoroughbred racing.

Although race field legislation has been introduced in several other Australian jurisdictions, the method adopted for the levying of fees differs from State to State. In fact the racing industries in some States as well as the greyhound racing industry in New South Wales have seen fit to adopt a gross profit model.

Racing NSW considers that it is more appropriate for it to assess its fees under the NSW race field’s regime on turnover rather than other measures such as “gross profit” for reasons which include:

- basing the fee on turnover removes the exposure which would exist in fees based on “gross profit” to an individual wagering operator’s commercial and

strategic decisions including its business model, pricing decisions and its success in managing its risk. All of these issues are commercial and operational matters for individual wagering operators and their management and are outside the influence or control of Racing NSW;

- anything other than turnover means that the industry becomes a silent partner of the operator without any input into the operator's business model and without having any certainty as to the level of revenue it can expect to receive. In addition in an endeavour to increase his market share an operator can reduce his operating margins substantially thereby reducing the industry's revenue stream;
- turnover has the same relationship with the amount wagered by each punter irrespective of the wagering operator through which the punter places the wager;
- the race fields legislation is commercially analogous to the owner of intellectual property granting non-exclusive licenses to a large number of competing operators. This allows each licensee to determine his own strategy, business model and consumer pricing and the intellectual property owner does not become exposed to those issues or the efficiency of the licensee's operations;
- turnover is a recognized basis for assessing fees and taxes in the wagering and racing industries. NSW bookmakers currently pay fees to NSW racing clubs based on turnover. Fees charged to international wagering operators for broadcasts of NSW racing for wagering purposes are assessed on the basis of turnover, as are fees charged by international racing industries (e.g. New Zealand, Hong Kong, US) to many Australian wagering operators who bet on their events. Although the basis on which State wagering taxes are assessed varies, certain States and Territories assess their wagering taxes based on turnover. Indeed the NSW Government imposed tax on NSW bookmakers based on turnover prior to the abolition of State wagering tax on NSW bookmakers. Further, in the Northern Territory where the majority of corporate bookmakers are licensed the Government still taxes bookmakers on the basis of turnover;
- basing the fee on turnover prevents the amount of fees received by Racing NSW being influenced by the outcome of individual events, an important issue for Racing NSW given its statutory responsibilities for the NSW thoroughbred racing industry and industry integrity and the importance of avoiding perceptions of potential conflicts of interest;
- a single basis of fees needs to apply across the various types of wagering, including totalizators (where turnover and revenue are directly proportionate with the relationship being set through a pre-determined take-out rate), fixed-odds betting (where the operator is "on-risk" as to the outcome of an event) and betting exchanges (where the operator is not a party to the wagering

transaction but rather charges a commission which is set on a basis and at a level determined by the betting exchange operator at his discretion).

- turnover-based fees enable Racing NSW to maintain “neutrality” amongst wagering operators by limiting the impact on Racing NSW’s revenue of the relative success of various operators. Fees based on “gross profit” will always leave Racing NSW’s revenue-base exposed to a transfer of turnover from “higher margin” operations to “low margin” operations.
- wagering provides the majority of the funding of the racing industry. Accordingly, to base fees on “gross profit” would result in wagering operators who, for whatever reason (e.g. regulation, product offering, business model, pricing, management skill), are successful in achieving higher gross margins effectively subsidizing the cost of the racing product for operators who can not, do not or choose not to achieve the same margin;
- gross profit can be manipulated in an operator’s business in a number of different ways such as disguising marketing expenses as payments on winning bets by offering excessive odds or providing free bets to journalists and media commentators on the basis of receiving free publicity and advertising. Further as a promotion the operator could give out free bets on an event. These strategies would artificially reduce his gross profit figure.
- because Racing NSW does not regulate the operations of interstate wagering operators it is not able to satisfy itself that operators are not placing bets on winners after the running of the race thereby reducing their gross profits. There have been numerous examples of this practice occurring. The practice was referred to in the Woodward Royal Commission into drug trafficking.
- where bookmakers “bet-back” amounts with totalizators it is not uncommon for them to receive rebates/inducements of up to 6% of turnover. However, there is no guarantee that these amounts would be included in the bookmaker’s gross profit figure on which he calculates his payments to the racing industry.
- turnover-based fees are easier to assess and administer across a number of wagering operators who offer different types of wagering.

The decision of Racing NSW to charge fees based on turnover has now been challenged by the betting exchange operator, Betfair which has instigated litigation in the Federal Court seeking to have the decision overturned on the grounds that it is invalid and unconstitutional.

Racing NSW believes that it is imperative that each State Racing body retain the ability to set fees based on such criteria as it believes appropriate.

Accordingly it is recommended that the Commission support the implementation of a national approach to this issue, particularly in respect of ensuring the constitutionality surrounding the application of race field fees

and putting beyond doubt the ability of a State racing controlling body to apply fees in a manner best suited to its particular circumstances.

Tote-Odds Betting

Until the late 1990's, totalizator betting was confined to persons or organizations licensed by State Governments in accordance with relevant legislation whereas fixed odds betting was offered primarily by bookmakers operating on racecourses throughout the country. Under that scenario bookmakers operated a risk/reward business by establishing a market on a race and accepting bets from punters at the quoted price about a particular runner.

Prices about individual runners fluctuated during the course of betting depending on the weight of investments on the various runners. Minor variations were applied where the bookmaker allowed a punter to place a bet on a runner where the payment would be based on the price of the runner at the close of betting (starting price) or on the best odds offered during the course of betting (best fluctuation). In both cases however the price was determined on the basis of bookmakers' fixed odds.

A practice has now arisen where Tote-odds betting is being offered by bookmakers in certain jurisdictions, thereby providing a customer with odds which are not fixed, but rather determined by reference to the highest dividends declared by any of the three main TABs (i.e. NSW TAB, UNiTAB and SuperTAB) or at a premium to TAB dividends. Such products therefore directly target totalizator customers and do so by "free riding" on the commercial investment which TABs have made in their totalizator operations without the bookmakers who offer "tote-odds betting" having to pay the same wagering taxes and fees to the racing industry as the totalizator operators or invest in the systems and distribution required for a totalizator operation.

Unlike traditional bookmaking operations, the winning returns from tote-odds betting are not known until the race is concluded and dividends are declared by the various totalizator operators.

In many cases wagering operators offering tote-odds betting are not operating as bookmakers but are merely acting as a conduit by accepting bets from investors then channeling those investments through to the totalizator in one of the smaller states where State taxes are considerably lower or non-existent, while at the same time receiving cash rebates from that totalizator operator. Accordingly the State in which the event is being conducted and where the punter resides is being denied the revenue which would be derived from that betting.

Racing NSW believes that the practice threatens the integrity of the overall totalizator system as very large amounts of money are being invested through the totalizator system at the last possible moment before betting closes thereby significantly altering the dividends payable on each runner in the race. Even a perception that the totalizator is not being operated fairly can lead to a significant

loss of confidence in the system by recreational punters with a resultant downturn in investments and therefore reduced revenue for the racing industry.

Apart from the integrity concerns, the practice of tote-odds betting is causing a major diversion of investments from traditional totalizator betting which has to date been the principle source of revenue for the racing industry. Racing NSW is of the opinion that tote-odds betting represents the single biggest threat to the finances and future viability of the racing industry.

Racing NSW therefore recommends that the commission support the introduction of legislation to amend the Interactive Gambling Act 2001 (Cth) to prohibit the offering of totalizator odds betting by persons other than licensed totalizator operators and unless that operator is actually conducting a totalizator. In other words unless a wagering operator is licensed to conduct a totalizator, that operator should be compelled to offer a fixed price about a runner at the time the operator accepts a bet from a punter and payments should only be based on bookmaker odds with returns being known prior to the start of a race.

Overseas wagering operators

In response to concerns within the wider community over the social issues involved with the advent of gambling by Australian citizens over the internet, the then Federal Government enacted the Interactive Gambling Act 2001.

It was initially intended that this legislation would ban the licensing of any on-line gambling operation in Australia and would prohibit any operator (whether in or outside of Australia) from accepting bets from Australian citizens.

Following submissions from various parties, including the Australian Racing Board, the Government "carved-out" internet wagering from the prohibitions. Unfortunately, this "carve-out" applied to both Australian and overseas based wagering operators.

This has given overseas wagering operators unfettered access to the NSW and Australian markets. With the growth of internet and telephone betting, offshore operators are increasingly able to actively target NSW residents, thereby undermining the integrity of the NSW regulatory and policy framework.

Coupled with the minimal regulatory restrictions in some jurisdictions, the integrity of the Australian racing industry is being placed at considerable risk. In addition as betting is transferred off-shore, Government (State and Federal) and industry revenues are also being affected.

Enforcement of the NSW race fields regime, and other NSW Government policy initiatives such as responsible gambling, against wagering operators who do not hold licenses in any Australian State or Territory will be difficult.

As in the USA, Hong Kong and other overseas jurisdictions, the regulatory framework should be strengthened to prevent access to the Australian market by wagering operators who do not hold a wagering license in an Australian State or Territory and maintain a base of operations in Australia. Such action will be most effective if supported by a Federal regime.

Similar steps have been taken internationally and could be adopted by the Federal Government introducing regulations restricting the wagering exemptions under section 8A of the *Inter-Active Gambling Act 2001 (Cth)* to wagering operators who are licensed in an Australian State or Territory and who have some operations in Australia.

Similarly and so as to strengthen these restrictions, the relevant legislation might be amended to prohibit Australian based financial institutions such as banks and credit card providers from transferring funds to and from overseas wagering operators. This situation applies in several other overseas jurisdictions, particularly the United States of America. These prohibitions should be complemented with significant penalties including monetary fines and criminal sanctions so as to ensure compliance with the legislation. This is the situation in the USA.

These initiatives would negate threats to the finances of the racing industry as well as protecting the integrity of the industry.

Accordingly it is strongly recommended that the commission support amendments to the Inter-Active Gambling Act 2001 to provide for the reinstatement of prohibitions which prevent overseas operators from providing wagering services to Australian residents and also introducing legislation making it an offence for an Australian licensed financial institution to process deposits and withdrawals between Australian punters and overseas wagering operators. These prohibitions should be complemented with significant penalties including monetary fines and criminal sanctions so as to ensure compliance with the legislation.

Racing NSW would be pleased to meet with you to add to its submission and provide any further information that the Commission may require.

I trust that the Commission will give every consideration to the issues raised in our submission.

Yours sincerely
RACING NSW



P N V'LANDYS
CHIEF EXECUTIVE

APPENDIX

Percentage of Returns to Owners as a Proportion of Training Costs Returned to Owners	COUNTRY	FUNDING MODEL
100 % +	Hong Kong	TOTALIZATOR ONLY
	Singapore	TOTALIZATOR ONLY
60 % - 100 %	Japan	TOTALIZATOR ONLY
	France	TOTALIZATOR ONLY
45 % - 60 %	USA	TOTALIZATOR ONLY
	AUSTRALIA	TOTALIZATOR DOMINANT
	South Africa	TOTALIZATOR DOMINANT
< 30 %	Ireland	BOOKMAKER DOMINANT
	Germany	BOOKMAKER DOMINANT
	Britain	BOOKMAKER DOMINANT

Source: International Federation of Horseracing Authorities (September 2008)

