

Report to the Governor and the General Assembly of Virginia

Oversight and Administration of Gaming in the Commonwealth

2022



COMMISSION DRAFT

Joint Legislative Audit and Review Commission

Senator Janet D. Howell, Chair

Delegate Robert D. Orrock, Sr., Vice Chair

Delegate Terry L. Austin

Delegate Kathy J. Byron

Delegate Betsy B. Carr

Delegate Barry D. Knight

Senator Mamie E. Locke

Senator Jeremy S. McPike

Senator Thomas K. Norment, Jr.

Delegate Kenneth R. Plum

Senator Lionell Spruill, Sr.

Delegate Luke E. Torian

Delegate R. Lee Ware

Delegate Tony O. Wilt

Staci Henshaw, Auditor of Public Accounts

JLARC staff

Hal E. Greer, Director

Tracey R. Smith, Associate Director

Stefanie Papps, Principal Legislative Analyst, Project Leader

Ellie Rigsby, Senior Legislative Analyst

Information graphics: Nathan Skreslet

Managing editor: Jessica Sabbath

Contents

Summary	i
Recommendations	vii
Chapters	
1. Virginia's Expanding Gaming Environment	1
2. Creating a Central Gaming Agency	13
3. Regulating Wagering on Horse Racing	21
4. Regulating Charitable Gaming	39
5. Unregulated Electronic Gaming Machines	49
Appendixes	
A: Study resolution	55
B: Research activities and methods	57
C: Agency responses	65

Summary: Oversight and Administration of Gaming in the Commonwealth

WHAT WE FOUND

Legal gaming has expanded rapidly in Virginia

For decades in Virginia, legal gaming was limited to charitable gaming to raise money for charitable organizations, the state lottery to raise money for K–12 education, and pari-mutuel wagering on live horse races to raise funds for Virginia’s horse industry. Wagering in Virginia reached \$3.4 billion in 2018 when just those three forms of gaming were legal in the state.

Many states have recognized gaming’s ability to raise state and local revenues and, similar to Virginia, have gradually legalized new forms of gaming. For example, Maryland legalized casinos in 2008, West Virginia legalized online gaming in 2019, and Tennessee legalized sports wagering in 2019. After studying the potential revenue and economic impacts of casinos and sports wagering, the General Assembly legalized those forms of gaming in 2020.

In addition to the new gaming options in Virginia, the forms of gaming that were legal prior to the recent expansions have offered new ways to gamble. Electronic pull tab machines were introduced as a new form of charitable gaming in 2012, historical horse racing (HHR) machines began operating in 2019 as a new form of pari-mutuel wagering, and lottery tickets have been sold on the internet since 2020. In 2021, Virginians wagered \$9.4 billion on legal forms of gaming in the Commonwealth, almost triple what Virginians wagered three years earlier.

Legal gaming is poised to continue growing in Virginia. Two new HHR facilities are under construction, the state’s four voter-approved casinos will open in the next several years (a temporary casino is currently open in Bristol), and JLARC staff estimate that by 2025, as wagering on existing gaming increases and casinos open, annual wagering in Virginia will reach \$21 billion. In addition, unregulated gaming has proliferated across the state over the past several years through electronic gaming terminals in convenience stores, truck stops, and restaurants referred to as “gray machines” by the gaming industry and as “games of skill” by the machines’ owners. As of the date of this report, these machines’ legal status remains in question.

Three state agencies are responsible for regulating gambling. The Virginia Lottery regulates and operates the state lottery and regulates casino gambling and sports

WHY WE DID THIS STUDY

In January 2022, the Joint Legislative Audit and Review Commission (JLARC) directed staff to conduct a review of Virginia’s approach to regulating the state’s various legal forms of gaming. The study resolution required staff to assess the advantages and disadvantages of consolidating the administration and oversight of Virginia’s gaming activities into a single agency.

ABOUT GAMING IN VIRGINIA

Several new forms of gaming have begun operating in Virginia over the past five years, including casinos, sports wagering, poker for charitable organizations, historical horse race wagering games, and “games of skill”/“gray machines.” Governments regulate gaming to protect citizens from gaming-associated risks and to ensure that legal forms of gaming generate funds for stated purposes, such as K–12 education or economic revitalization. Three Virginia state agencies are responsible for regulating gaming. In 2021, Virginians wagered \$9.4 billion on legal gaming.

betting. The Virginia Department of Agriculture and Consumer Services (VDACS) regulates all charitable gaming, and the Virginia Racing Commission (VRC) regulates live horse racing and associated wagering and HHR. Gaming regulation is not the primary function of VRC and VDACS. Both agencies need more staff and better technology to ensure that all gaming under their purview operates with integrity.

VRC does not have adequate staffing, expertise, or regulations to effectively oversee HHR

Effective regulation contributes to Virginians' perceptions of the gaming industry's fairness and reputability, but VRC has not taken actions necessary to effectively regulate large-scale commercial gaming, which HHR wagering has become. VRC's primary mission is to promote, sustain, grow, and regulate Virginia's native horse racing industry. VRC has four full-time employees, none of whom has the experience necessary to regulate HHR machines, which are similar to slot machines, effectively. Despite the rapid expansion of the number of HHR machines and facilities and volume of wagering, VRC has only added a part-time HHR compliance specialist responsible for reviewing HHR facilities' security and operations procedures.

VRC contracts with a third party to conduct formal on-site inspections of HHR facilities—but only two such inspections are conducted per year across all facilities, and they are focused exclusively on the operation of the HHR machines versus the day-to-day operations of the facilities themselves. In addition, VRC has not promulgated regulations that establish sufficient requirements for HHR licensure or operations, nor has it established sufficient agency policies or processes for ensuring the HHR operator's compliance with regulatory requirements.

VDACS is not staffed to sufficiently regulate charitable gaming

Regulating charitable gaming is a minor function for VDACS, whose primary purposes are to promote growth of Virginia agriculture, provide consumer protection, and encourage environmental stewardship. VDACS has 21 positions dedicated to regulating charitable gaming, but 10 gaming positions are vacant. VDACS does not have enough staff to conduct a sufficient number of audits or inspections of organizations that sponsor charitable gaming, and the vacant positions have been difficult to fill. VDACS may also have difficulty hiring staff to assume its recently assigned responsibility to regulate electronic pull tab machines and Texas Hold 'Em poker tournaments.

Establishing a single state gaming agency would ensure effective and efficient regulation across all gaming formats

A central gaming agency can focus on gaming regulation as a core mission and more readily develop the expertise to understand and react appropriately to the rapidly changing gaming industry. A single agency would provide the public; the General Assembly; the executive branch; and gaming owners, operators, employees, vendors,

and others with a single point of contact for emerging gaming-related issues. Additionally, a central gaming agency would concentrate regulatory staff's knowledge and understanding of the gaming industry in one place. Over time, these staff should become a group of highly skilled employees specialized in effective gaming regulation. Working at one agency where regulation of gaming is a core mission would facilitate staff's ability to share knowledge, experiences, ideas, and successful practices with one another, which would elevate the abilities and expertise of all staff and facilitate cross training.

A central gaming agency would also provide some ability to streamline the information technology (IT) component of gaming regulation. As the operation and play of gaming becomes more electronic, electronic systems are the most efficient and effective means of monitoring and auditing gaming, especially HHR machines, electronic pull tab machines, and slot machines.

A central gaming agency would also better ensure that the state's problem gambling prevention and treatment efforts are robust, consistent, and coordinated. Despite the rapid expansion of gaming activities over the past few years, Virginia's problem gambling prevention and treatment efforts have not been uniformly prioritized across Lottery, VRC, and VDACS.

Virginia Lottery could best serve as Virginia's central gaming agency, with some additional cost

Lottery has demonstrated the ability to respond effectively to its expanded gaming responsibilities and is well positioned to become Virginia's central gaming agency. Lottery's central mission is gaming, and the agency has information technology and staff expertise it could use to help improve regulation of HHR and charitable gaming. In addition, Lottery has recent experience quickly building staffing and implementing regulations for casino gaming and sports wagering, which are thorough and conform to industry standards.

Creating a new agency, such as a gaming commission, responsible for regulating all forms of gaming has several drawbacks and is not a practical option. Lottery has already begun regulating casinos and sports wagering and has hired nearly half of the employees needed to do this work. Transitioning the regulation of casinos and sports wagering to a gaming commission would create disruption and uncertainty among those staff and would require establishing a new leadership structure and staff.

Regulation of charitable gaming and HHR should be transferred to Lottery. Consolidation would not achieve staffing, administrative, or procedural efficiencies because VRC and VDACS are currently understaffed for their gaming responsibilities, and additional staff are needed to adequately regulate charitable gaming and HHR wagering.

VRC could be staffed and resourced to appropriately regulate HHR, and its board membership requirements could be changed to ensure that board members have the

expertise needed to regulate a large commercial gaming operation. However, increasing the agency's size and expanding its day-to-day responsibilities to the extent required would be difficult for this four-person agency to successfully carry out, and a significant amount of the staff's time and attention would need to shift to HHR and away from live horse racing. Additionally, VDACS has faced obstacles to filling the positions it needs to effectively regulate charitable gaming, which would likely be less of a challenge at Lottery because of its higher salaries.

Consolidating regulation of gaming under Lottery would cost more than keeping regulation at VRC and VDACS because of Lottery's higher employee salaries. Virginia Lottery would need at least 20 new staff positions, and 21 existing positions would need to be transferred from VDACS to Lottery. Consolidation under Lottery would cost approximately \$5.7 million in total, which is \$3.5 million more than is currently being spent on regulating HHR and charitable gaming. Most of the increase, \$3.1 million, is because of additional positions that will be needed, and the rest, \$0.4 million, is because of higher salary costs at Lottery.

VRC should continue regulating live horse racing and related wagering; HHR license should be conditional on live racing license

Live horse race wagering is the only form of legal gambling that should not be regulated by Lottery. Instead, VRC should continue to regulate live horse racing. Live horse racing and associated wagering have been the long-time primary focus of the VRC, and the agency's staff and board members have deep, valuable expertise in these areas. Further, VRC and its staff have a long-standing role in horse racing, ensuring animal welfare and that races are run safely and fairly. These functions and expertise make regulating horse racing different from regulating other forms of gaming.

If Lottery regulates HHR, its issuance of the HHR operator license could be conditioned on VRC *first* granting the HHR operator a license for *live racing*. This would ensure that the HHR operator is fully meeting its responsibility to conduct live horse racing in the manner expected. This conditional licensure requirement would ensure that VRC can prevent the operator from conducting HHR in Virginia if it is not fulfilling its live racing responsibilities, even if VRC no longer regulates HHR. Moreover, this requirement would further ensure that—regardless of what state entity regulates HHR operations—HHR continues to operate for the benefit of Virginia's horse industry and live horse racing, which was the General Assembly's original intent in authorizing it.

WHAT WE RECOMMEND

Legislative action

- Require the agency responsible for regulating HHR to promulgate regulations that establish licensing and operating requirements that are similarly rigorous to those in place for commercial gaming owners and operators,

like casinos. This includes subjecting HHR employees with the most control over HHR operations to the greatest scrutiny for licensure; conducting thorough, in-depth licensure background investigations; approving the HHR operator's internal controls for day-to-day operations; and establishing mechanisms that the regulatory agency can use for enforcing regulations, such as financial penalties or corrective action plans.

- Require the agency responsible for regulating HHR to develop internal policies for ensuring the HHR operator's compliance with state laws and regulations, including procedures for inspecting facilities and conducting routine financial and operational audits.
- Designate the Virginia Lottery as the state's central gaming regulation agency.
- Create a state policy office within Virginia Lottery to monitor, study, and advise state officials about new and emerging forms of gaming.
- Reassign the regulation of charitable gaming from VDACS to Lottery.
- Reassign the regulation of HHR from VRC to Lottery.
- Add two new Lottery Board positions, one to be filled by someone with a charitable gaming background and one with a horse racing background.
- Require that HHR operators have an active significant infrastructure limited license from VRC to obtain a license to conduct HHR gaming, if VRC no longer regulates HHR for the state.

The complete list of recommendations is available on page vii.

Recommendations: Oversight and Administration of Gaming in the Commonwealth

RECOMMENDATION 1

The General Assembly may wish to consider amending §58.1-4003 of the Code of Virginia to designate the Virginia Lottery as the state's central gaming agency and rename the agency Virginia Lottery and Gaming. (Chapter 2)

RECOMMENDATION 2

The General Assembly may wish to consider including language in the Appropriation Act directing the Virginia Lottery to establish a gaming policy office that will monitor new developments, trends, technologies, and types of gaming as well as unregulated forms of gaming and provide research and policy support to policymakers on issues related to gaming regulation. (Chapter 2)

RECOMMENDATION 3

The General Assembly may wish to consider amending the Code of Virginia to require the agency responsible for regulating historical horse racing (HHR) to promulgate regulations for licensing the HHR operator, suppliers, and employees that incorporate established best practices for the licensure of casinos. Regulations should, at a minimum 1) subject individuals with the most control over HHR operations, including facilities' managers, to the most scrutiny, including personal, financial, and criminal background investigations; 2) require the regulatory agency to conduct thorough criminal, financial, and personal background investigations and verify information provided in licensure applications; and 3) require the HHR operator to meet certain conditions before receiving a license to open a facility. (Chapter 3)

RECOMMENDATION 4

The General Assembly may wish to consider amending the Code of Virginia to (i) require that licensing fees for historical horse racing (HHR) be sufficient to defray the regulatory costs of licensure and be consistent with the risks and potential profit associated with HHR and (ii) give the agency regulating HHR up to one year to license the HHR operator. (Chapter 3)

RECOMMENDATION 5

The General Assembly may wish to consider amending the Code of Virginia to require the agency responsible for regulating historical horse racing (HHR) to promulgate regulations to ensure proper operations at HHR facilities and effectively minimize risks. At a minimum, regulations should require the regulatory agency to 1) establish internal control requirements for day-to-day operations of HHR facilities, 2) require the operator to submit an annual independent financial audit, including the management letter, 3) conduct regular, formal inspections of HHR facilities to identify and remedy any noncompliance, and 4) establish mechanisms that can be used for enforcing regulations. (Chapter 3)

RECOMMENDATION 6

The General Assembly may wish to consider amending the Code of Virginia to direct the agency responsible for regulating historical horse racing (HHR) to develop internal policies for ensuring the HHR operator's compliance with all applicable laws and regulations. At a minimum, the agency should establish (i) procedures for inspecting HHR facilities, observing operations and wagering at the facilities, and documenting any noncompliance; (ii) the aspects of operations and facilities to be inspected and observed and what constitutes a satisfactory inspection, (iii) procedures for routine financial and operational audits, and (iv) the frequency with which compliance activities will be conducted. (Chapter 3)

RECOMMENDATION 7

The General Assembly may wish to consider amending the Code of Virginia to direct the agency that is responsible for regulating historical horse racing to develop policies detailing how it will participate in statewide efforts to prevent and treat problem gambling. (Chapter 3)

RECOMMENDATION 8

The General Assembly may wish to consider amending Chapter 40 of Title 58.1 of the Code of Virginia to remove responsibility for regulating historical horse race wagering (HHR) from the Virginia Racing Commission and Chapter 29 of Title 59.1 of the Code of Virginia to assign regulatory responsibility for HHR to the Virginia Lottery. (Chapter 3)

RECOMMENDATION 9

If the Virginia Lottery is given responsibility for regulating historical horse racing, the General Assembly may wish to consider amending §58.1-4004 of the Code of Virginia to add one position to the Lottery Board that will be filled by a member of the Virginia Racing Commission who will serve as a voting ex officio member. (Chapter 3)

RECOMMENDATION 10

If the Virginia Lottery is given responsibility for regulating historical horse racing, the General Assembly may wish to include language in the Virginia Lottery's section of the Appropriation Act stating that historical horse racing has been authorized for the purpose of providing support and funding to Virginia's horse racing industry. (Chapter 3)

RECOMMENDATION 11

If the Virginia Lottery is given responsibility for regulating historical horse racing, the General Assembly may wish to consider amending §59.1-375 of the Code of Virginia to require that the historical horse racing operator have an active significant infrastructure limited license from the Virginia Racing Commission to be eligible to obtain a license from the Virginia Lottery to conduct historical horse racing. (Chapter 3)

RECOMMENDATION 12

The General Assembly may wish to consider amending §18.2-340.15 of the Code of Virginia to move authority for regulating charitable gaming from the Virginia Department of Agriculture and Consumer Services to the Virginia Lottery. (Chapter 4)

RECOMMENDATION 13

If the Virginia Lottery Board is given responsibility to regulate charitable gaming, the General Assembly may wish to consider amending §2.2-2455 and §2.2-2456 of the Code of Virginia to establish the Charitable Gaming Board as an advisory board to the Virginia Lottery with responsibility for advising the Lottery on the conduct of charitable gaming. (Chapter 4)

RECOMMENDATION 14

If the Virginia Lottery Board is given responsibility to regulate charitable gaming, the General Assembly may wish to consider amending §58.1-4004 of the Code of Virginia to direct that a position be established on the Lottery Board to be filled by a member of the Charitable Gaming Board who would serve as a voting ex officio member. (Chapter 4)

1 Virginia's Expanding Gaming Environment

In 2022, the Joint Legislative Audit and Review Commission (JLARC) approved a study resolution directing JLARC staff to assess the advantages and disadvantages of consolidating the regulation of Virginia's gaming activities into a single state agency. (See Appendix A for the study resolution.) The resolution directed JLARC staff to:

- evaluate the roles and responsibilities of each agency and the staffing and financial resources dedicated to them;
- identify potentially duplicative roles and responsibilities that could more efficiently and effectively be carried out under one agency;
- evaluate the effectiveness of each agency's enforcement policies and activities;
- compare and contrast the regulatory requirements used by each agency to carry out its roles and responsibilities, including licensing and inspection requirements;
- consider how, if at all, consolidation could affect the various missions of the agencies that regulate gaming; and
- examine other states' approaches to administering and supervising legal gaming.

To complete this study, JLARC staff conducted structured interviews with state agencies responsible for regulating gaming in Virginia; reviewed current laws, regulations, and policies governing gaming in Virginia; and researched other states' approaches to regulating legal gaming. (See Appendix B for more information on methods used for this study.)

Legal wagering almost tripled from 2018 to 2021 to \$9.5 billion, could reach \$21 billion by 2025

Wagering on legal gambling operations in Virginia almost tripled from 2018 as new forms of gaming were introduced. Until 2018, Virginia's legal gaming options, which included only traditional horse race wagering, charitable gaming, and the state-operated lottery (Table 1-1), generated approximately \$3.4 billion in sales and wagering. Because of gaming expansions, total wagering on legal gaming almost tripled from \$3.4 billion in 2018 to \$9.5 billion in 2021. This growth occurred before any casinos opened and while sports wagering was still ramping up. This wagering growth does not include any wagering on unregulated electronic gaming machines that have proliferated across the Commonwealth since 2018, which was estimated to be \$2.2 billion in FY21.

All dollar figures in this report are adjusted for inflation to 2021 dollars.

Unregulated electronic gaming machines are also referred to as gray machines in this report, and are commonly referred to as games of skill by the media and device manufacturers.

TABLE 1-1
Legal gaming in Virginia, as of 2018

Type of Gaming	Description
Lottery	Lottery offers games of chance, including daily drawing, scratch tickets, and nationwide jackpot games. Virginia Lottery operates the lottery, and products are sold statewide via sales agents and through subscription.
Charitable gaming	Charitable gaming includes bingo, pull tabs, raffles and other gaming variations conducted by qualified nonprofit organizations to raise money to support the organization or for charitable purposes.
Horse race wagering	Traditional horse race wagering is pari-mutuel wagering on the outcome of live horse races (in-person or via simulcast). Wagers can also be placed on races through advance deposit wager (ADW) providers, which allow players to fund an account in advance that they can use to place bets on horse races.

SOURCE: Code of Virginia and JLARC staff analysis.

Pari-mutuel wagering is a betting system in which all bets of a particular type are placed together in a pool, and payoff amounts are calculated by sharing the pool among all winning bets after a percentage is deducted from the pool for commissions. This type of wagering is common in horse racing.

Since 2018 each form of legal gaming has been authorized to operate new games to help compete in a changing and growing market—horse race wagering has expanded to include historical horse race (HHR) wagering, lottery has expanded to include sales over the internet through iLottery, and charitable gaming has expanded to include Texas Hold ‘Em poker tournaments (Table 1-2). In addition, the 2020 General Assembly authorized commercial gaming through online sports wagering, and five land-based resort casinos with slot machines, table games, sports wagering, and on-premises mobile gaming.

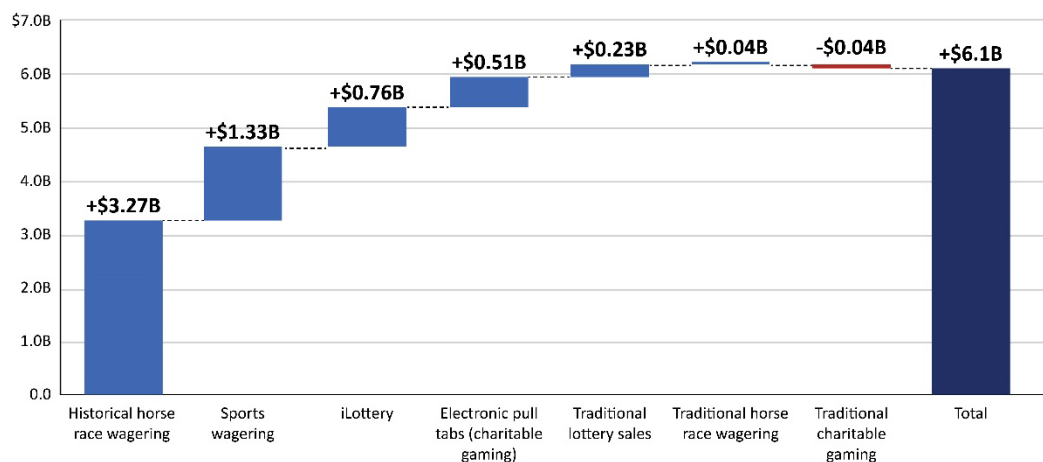
TABLE 1-2
Gaming expansions since 2018

Gaming expansion	Gaming type	Description
Historical horse racing (Authorized in 2018; play began in 2019)	Horse race wagering	Includes electronic gaming terminals similar in appearance to slot machines, and winning is determined by the results of previous live horse races.
iLottery (Authorized in 2020; play began in 2020)	Lottery	Refers to internet sales of lottery products via smart phones, computers, and other internet-enabled devices.
Texas Hold ‘Em poker tournaments (Authorized in 2020; play has not begun)	Charitable gaming	An organized competition of players who pay a fixed fee for entry into the competition and for a certain amount of poker chips for use in the competition.
Sports wagering (Authorized in 2020; play began in 2021)	Commercial gaming	Wagering on the outcomes of live or future sporting events. Wagers can be placed through online operators.
Resort casinos (Authorized in 2020; play began in 2022)	Commercial gaming	A brick-and-mortar building hosting a gaming floor with slot machines and table games, as well as having space dedicated to other amenities such as a hotel, restaurants, retail, and meeting and event space.

SOURCE: Code of Virginia and JLARC staff analysis.

Wagering on all forms of legal gaming grew \$6.1 billion in three years. Historical horse racing, sports wagering, and iLottery account for over 85 percent of the growth in wagering (Figure 1-1). Only traditional charitable gaming (e.g., bingo, raffles, paper pull tab cards) experienced a decline in wagering.

FIGURE 1-1
Wagering grew by \$6.1 billion between 2018 and 2021



SOURCE: JLARC staff analysis of data from VRC, Virginia Lottery, and OCRP.

NOTE: Figures are rounded and adjusted to 2021 dollars.

Introduction of historical horse racing accounts for 54 percent of the increase in wagering

In 2018, the Virginia General Assembly authorized historical horse racing (HHR) wagering to help fund Virginia's horse racing industry. Virginia's primary live racing track, Colonial Downs, closed for live thoroughbred racing in 2014 because of declining wagering and a disagreement between Virginia's horsemen's association and the owner of Colonial Downs. HHR wagering, which is done on terminals resembling slot machines, was seen as a way to help revitalize the state's horse racing industry and allow live racing to be re-introduced. Once legislation passed allowing HHR wagering, a new owner purchased Colonial Downs, and Colonial Downs re-opened with HHR terminals in April 2019. Since April 2019, Colonial Downs has opened five additional facilities, called Rosie's Gaming Emporiums, which feature HHR terminals.

While HHR games are based on the results of previously run horse races (sidebar), the player experience is nearly identical to that of slot machines. HHR machines are designed to look, sound, and play like traditional slot machines. The primary differences are in how the machines operate. In addition to technically being based on previously run horse races, HHR machines are linked to form a betting pool among players, and all prize payouts come from that pool. As a result, Virginia law considers HHR betting to be pari-mutuel, like live horse race wagering. However, HHR's connection to horse racing is irrelevant to actual game play.

HHR terminals technically are based on the outcomes of random, non-identified previous horse races. Players can choose winners based on anonymous statistics for the horses, **but most use the default automatic option that allows players to use the machines like slot machines.**

“ They play, spin, and feel like the games you know and love. ”

– Rosie's advertisement for HHR

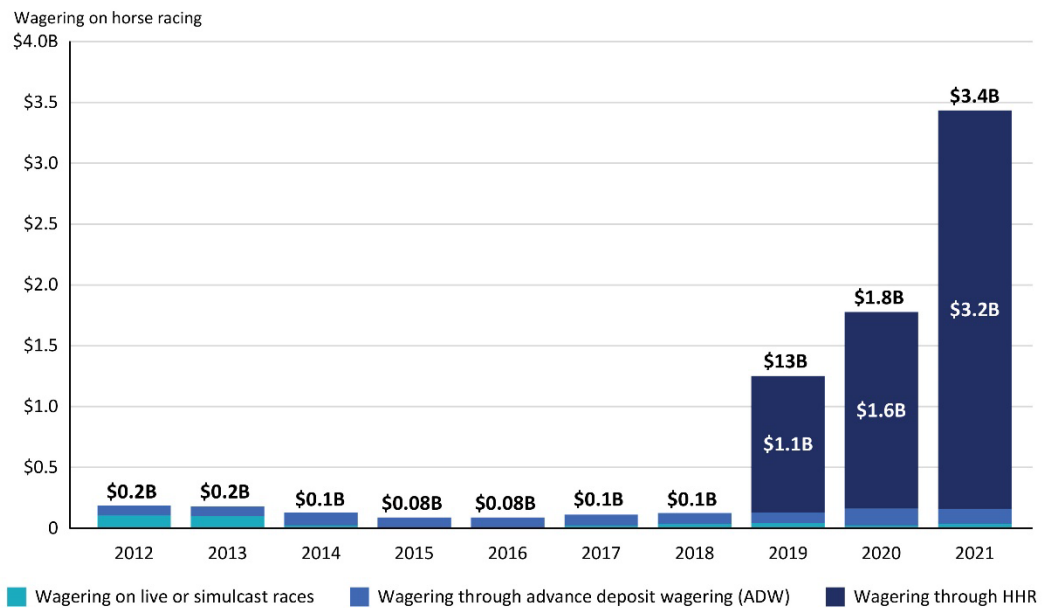
The introduction of HHR drove the majority (54 percent) of the total wagering growth in Virginia's legal gaming over the past four years. Wagering on all forms of horse racing grew from \$124 million in 2018 to \$3.4 billion in 2021 (Figure 1-2), mostly due to HHR, which accounts for 95 percent of horse race wagering. Proceeds for Virginia's horse industry grew fivefold during this time, growing from \$8 million before HHR was introduced (2018) to \$30 million in the most recent year (2021).

State law allows for up to 5,000 HHR terminals to operate in the state. Once the new Emporia and Dumfries locations open, almost 4,000 terminals will be operating in Virginia. Additional HHR facilities could open in the future housing the additional 1,000 HHR terminals authorized in state law.

Rosie's will continue to grow, and two new facilities will open by 2025 (sidebar). As of June 2022, 2,629 HHR terminals were operational at six locations: Colonial Downs in New Kent County; Richmond City; Hampton; Dumfries in Prince William County; Vinton in Roanoke County; and Collinsville in Henry County. Colonial Downs plans to open a facility in Emporia with 150 HHR terminals in summer 2023 and a second HHR facility in Dumfries, which will have up to 1,200 HHR terminals and will open by the beginning of 2024. The new Dumfries HHR location is being marketed as a gaming resort that will include a luxury hotel, eight bars and restaurants, a 1,500-person entertainment venue, a meeting and event space, and green space.

FIGURE 1-2

Wagering on historical horse racing terminals accounts for most of the wagering on horse racing



SOURCE: JLARC staff analysis of data from VRC.

NOTE: Figures are rounded and adjusted to 2021 dollars.

Introduction of iLottery and sports wagering accounts for almost 40 percent of wagering growth

Legislation passed in 2020 authorized the Virginia Lottery (Lottery) to begin selling lottery products over the internet. Internet lottery sales began on July 1, 2020. In the

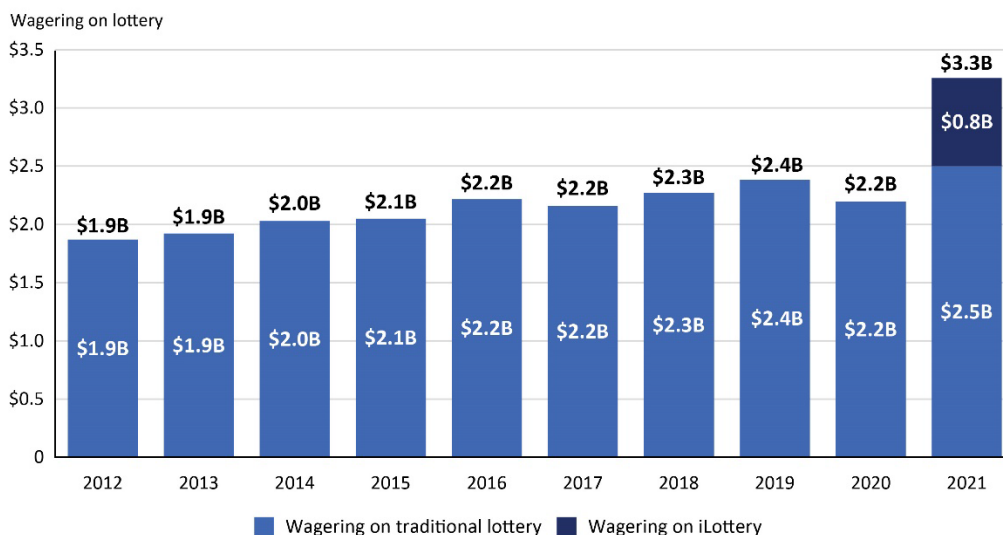
first year of internet lottery sales (FY21), iLottery wagering accounted for 23 percent of all lottery sales, which totaled \$3.3 billion (Figure 1-3).

During the 2020 General Assembly session, legislators authorized sports wagering through online platforms and assigned regulatory authority to the Virginia Lottery. Lottery began issuing sports betting operator licenses in January 2021 and has issued 13 operator licenses. In the first year of sports wagering, FY21, Virginians wagered over \$1.3 billion on sports. According to Virginia Lottery's preliminary data for FY22, Virginians had wagered \$4.3 billion on sports in the most recent year.

Growth in Lottery and sports wagering accounts for approximately 34 percent of the \$6.1 billion increase in wagering on all legal gaming over the past four years.

FIGURE 1-3

Internet lottery sales made up over 20 percent of lottery sales in its first year



SOURCE: JLARC staff analysis of data from Virginia Lottery.

NOTE: Figures are rounded and adjusted to 2021 dollars.

Expansion of charitable gaming through electronic pull tab terminals also accounts for some of the increase in wagering

The other major change that occurred in Virginia's gaming environment in the past decade was the introduction of electronic pull tab terminals. Electronic pull tabs, which are slot-like electronic gaming terminals, were permitted in Virginia in November 2012. Electronic pull tabs can be played in a charitable organization's social quarters by members and their guests (sidebar).

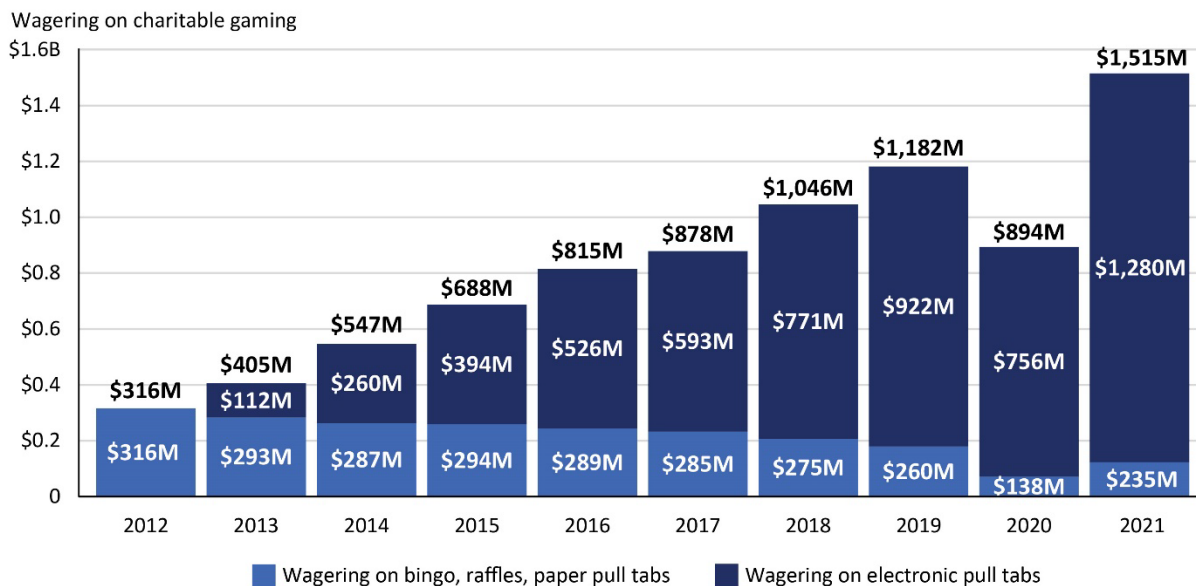
Wagering on charitable gaming totaled \$1.5 billion in 2021, and wagering on electronic pull tab terminals accounts for approximately 84 percent of this total (Figure 1-4). Wagering on traditional forms of charitable gaming (such as bingo, raffles, and paper

Social quarters refer to the areas of a charitable organization only accessible to its members. Examples include a Veterans of Foreign Wars post, Elk's Club, or Moose Lodge.

pull tab or seal cards) declined \$81 million between 2012 and 2021. In contrast, annual wagering on electronic pull tabs grew almost \$1.3 billion over that same time period. Growth in electronic pull tab wagering accounted for about 8 percent of the overall increase in wagering between 2018 and 2021 (across all forms of gaming).

FIGURE 1-4

Wagering on electronic pull tabs accounts for the majority of wagering on charitable gaming



SOURCE: JLARC staff analysis of data from OCRP.

NOTE: Figures are rounded and adjusted to 2021 dollars. Amount of electronic pull tab play in private social quarters and during bingo games is estimated based on OCRP's staff estimate that 92 percent of electronic pull tabs were in social quarters, and 8 percent were in bingo locations.

Pandemic slowed the growth in wagering and expansion of gaming options in Virginia

Gaming sales declined for most forms of gaming in 2020 because of the COVID-19 pandemic. Forms of gaming that rely on in-person interaction, such as a bingo game or a horse race, had the largest reductions in wagering in 2020. Total wagering on charitable gaming declined 24 percent in 2020. Likewise, wagering on live and simul-cast horse races declined 42 percent. Even lottery sales declined 8 percent. However, wagering on horse races through advance deposit wagering and HHR wagering both grew in 2020.

The pandemic also affected the pace of gaming expansion in Virginia. Although HHR wagering grew in 2020, wagering likely grew more slowly than it would have otherwise, because HHR facilities shut down from March 15, 2020 to July 1, 2020, losing over

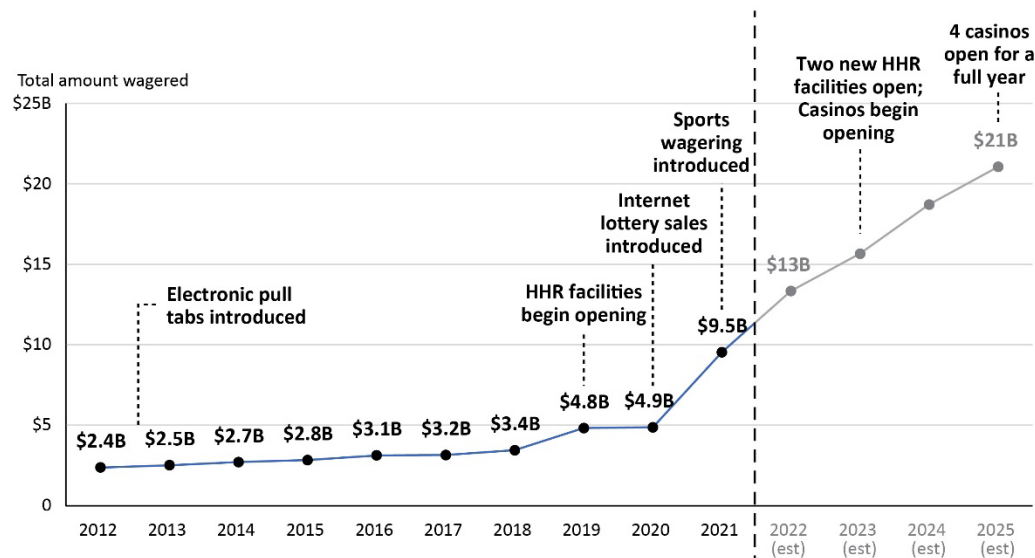
three months of business. Additionally, the developer for the Danville casino has recently announced that the casino's opening will be delayed to 2024 because of supply-chain and labor issues resulting from the pandemic.

Existing and new gaming options will continue to increase for the next few years

Gaming options and availability will continue to grow over the next few years. Between 2021 and 2025, four resort casinos are expected to open, and two additional HHR facilities with up to 1,350 additional HHR terminals will open. Additionally, sports wagering is expected to continue growing as the sports wagering platforms become fully operational. Based on the expected growth in existing gaming options and new gaming establishments expected to open soon, total wagering on legal forms of gaming in Virginia could total \$21 billion by 2025 (Figure 1-5).

FIGURE 1-5

Total wagering has grown significantly since 2018 and is expected to continue growing



SOURCE: JLARC staff analysis of data from Lottery, VRC, and OCRP; and the 2019 Innovation Group report on expected gaming revenue.

NOTE: Figures are rounded and adjusted to 2021 dollars. Wagering estimates for future years developed assuming growth rates based on previous years, as well as future plans for expansion. Future year estimates do not assume any wagering from Texas Hold 'Em poker tournaments.

All charitable gaming is permitted as a means of funding qualified charitable organizations. Regulations require charities to contribute 10 percent of gross gaming receipts from traditional charitable gaming to charity, called the “**use of proceeds**” requirement. No specific use of proceeds requirement currently exists for electronic pull tab receipts.

Chapter 767 and 722 of the 2022 General Assembly session require the commissioner to complete work on the electronic pull tab regulations by September 15, 2022.

Several horse industry groups benefit from revenue generated by horse race wagering, including:

Virginia Equine Alliance (VEA) is a nonprofit organization that includes industry stakeholders to sustain, promote, and expand Virginia's horse breeding and racing industries.

The **Virginia Breeders Fund** is a financial incentive program to encourage thoroughbred and Standardbred breeding.

The **Virginia Horse Center** is a nonprofit facility that hosts equestrian events in Lexington.

The **Virginia Horse Industry Board** is a commodity board that operates through VDACS to promote and develop economic opportunities for Virginia's horse industry.

Gaming expansions generated funding for K-12 education, charitable organizations, the state's horse industry, and the state and local governments

The expansion of wagering in Virginia has also led to growth in proceeds for public purposes. Under Virginia law, each legal gaming option supports various purposes, and in 2021, gaming provided over \$870 million to those purposes, compared with \$700 million in 2018 (adjusted for inflation).

Lottery sales support Virginia's public K–12 education system, and funds generated for education have increased approximately 36 percent since 2012. In 2021, lottery sales contributed approximately \$767 million to education, compared with \$563 million in 2012 (adjusted for inflation). Prior to the pandemic, lottery proceeds averaged 3 percent annual growth. When iLottery sales were introduced in 2021, lottery proceeds increased 26 percent.

Charitable gaming is permitted in the Commonwealth to help qualified charitable organizations raise money, and the amount of funds raised for charities has more than doubled since 2012. In 2021, charitable gaming contributed an estimated \$77 million to charitable causes, compared with an estimated \$35 million in 2012 (adjusted for inflation). This growth is primarily attributable to growth in sales and proceeds from electronic pull tabs at social quarters, which have increased 29 percent annually, on average before the pandemic (adjusted for inflation) (sidebar). Proceeds generated by bingo events declined by an average of 2 percent annually over the same time period.

Horse race wagering proceeds support Virginia's horse racing industry, and total funds contributed to horse racing interests have nearly tripled since 2014. In 2021, horse race wagering contributed approximately \$30 million to various horse racing interests, compared with approximately \$11 million in 2014 (adjusted for inflation). This growth is primarily attributable to the introduction of historical horse racing and resumption of live racing in 2019.

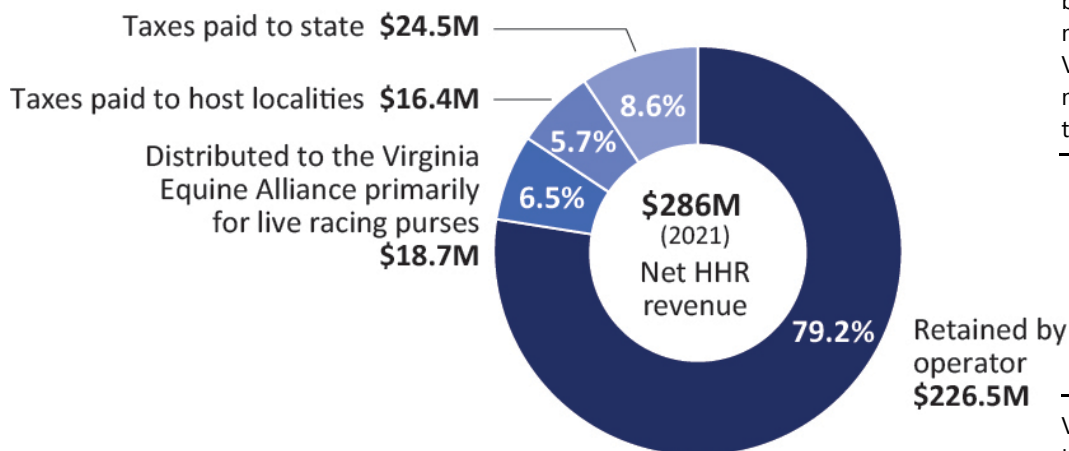
State law specifies that certain percentages of net gaming revenue support several recipients associated with the horse industry. *Traditional* horse race wagering revenue is distributed to

- a fund for live racing purses; and
- several horse industry stakeholders, including the Virginia Equine Alliance (VEA), the Virginia Racing Commission, Virginia Horse Center, Virginia Horse Industry Board, Virginia Thoroughbred Association, Virginia-Maryland Regional College of Veterinary Medicine, and the Virginia Breeder's Fund (sidebar).

In addition, taxes are paid to localities that host pari-mutuel wagering facilities.

HHR wagering revenue is allocated to fewer recipients (Figure 1-6). HHR revenues are primarily retained by Colonial Downs (operator of Colonial Downs live racing facility and Rosie's HHR facilities), with some of the remainder distributed to the VEA primarily to fund live racing purses, as well as to support the Virginia-Certified Residency Program (sidebar) and to cover operating costs associated with conducting harness and steeplechase racing (sidebar). A portion of the revenue is also paid in taxes to the localities that host HHR facilities, New Kent County (which has the Colonial Downs racetrack), and the state.

FIGURE 1-6
Distribution of historical horse racing net gaming revenue



SOURCE: Virginia Racing Commission.

NOTE: Net revenue represents the amount wagered minus the amount paid back to players as winnings—in 2021, net revenues were approximately 8 percent of the total amount wagered. This distribution of revenues reflects the distribution in 2021. Language in the Appropriation Act requires amounts to be distributed to the Virginia Breeders Fund, Virginia-Maryland Regional College of Veterinary Medicine, Virginia Horse Center, and Virginia Horse Industry Board beginning in FY23.

Horse race, sports, and casino wagering operators also pay state and local taxes. In 2021, horse race wagering operators paid over \$27 million in state taxes and over \$16 million in local taxes. Sports wagering operators paid \$5.6 million in state taxes in 2021. As of this report, casino wagering has been operational for one month at the Bristol casino, but in that single month, the casino operator paid \$2.1 million in state and local taxes.

Gaming regulation is handled by three separate state agencies

Three state agencies currently regulate Virginia's five forms of legal gaming (Figure 1-7). The Virginia Lottery operates and regulates the state lottery and regulates sports betting and casino gaming; the Virginia Racing Commission (VRC) regulates horse race wagering, including HHR; and the Office of Charitable and Regulatory Programs

The **Virginia-Certified Residency program** is an incentive program operated by the Virginia Thoroughbred Association to encourage owners to house and train their horses in Virginia. The program provides bonus payments on wins in certain races to horses that were not bred or born in Virginia, but maintained residency in Virginia for at least six months prior to turning two years old.

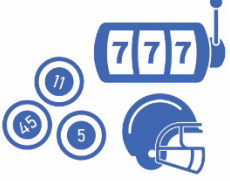


VEA receives funds from HHR through a **revenue sharing agreement** that requires Colonial Downs to make payments to a subset of horse racing stakeholder groups. Colonial Downs must pay **6 percent** of annual HHR net gaming revenue for wagers up to \$60 million—and **7 percent** of HHR revenue in excess of \$60 million—to this subset of horse racing stakeholder groups. The agreement also stipulates that Colonial Downs is not required to make any payments to the horse racing stakeholders on HHR net revenues generated at HHR facilities in their first year of operation.

OCRP at VDACS regulates **fantasy sports contests**, which allow players to wager on an online simulated game where winning outcomes are determined based on the accumulated statistical results of the performance of individuals on each fantasy team's roster. The Code of Virginia states that fantasy contests are not considered gambling, and so they are not addressed in this report.

(OCRP) at the Virginia Department of Agriculture and Consumer Services (VDACS) regulates charitable gaming (sidebar). Each agency and each form of gaming is subject to different laws, regulations, and operational standards.

FIGURE 1-7

Virginia Lottery, OCRP, and VRC are responsible for regulating gaming

	 Virginia Lottery	 OCRP	 VRC
Regulatory responsibilities	Virginia Lottery (operate and regulate); Casinos and sports betting (regulate)	Charitable gaming	Horse race wagering (live racing and HHR)
Governance	<ul style="list-style-type: none"> • Independent agency • Seven-member policy board 	<ul style="list-style-type: none"> • Executive branch agency (VDACS) • Nine-member advisory board 	<ul style="list-style-type: none"> • Executive branch agency • Five-member supervisory board
FTEs^a	279 (Lottery functions); 62 (gaming compliance)	11 ^b	4.5
Appropriation	\$164 million (Lottery); \$23 million ^c (gaming)	\$2.1 million	\$4.6 million ^d

SOURCE: JLARC summary of data and documents from the Virginia Lottery, OCRP, and VRC

NOTE: FY23 appropriations. ^a Filled positions as of 2022. ^b Only includes staff dedicated to regulating charitable gaming.

^c Lottery's budget for gaming compliance increased to \$23 million in FY23. ^d VRC budget increased to \$4.6 million in FY23 to fund new full-time licensing and seasonal positions.

State law authorized up to five resort casinos with one located in Bristol, Portsmouth, Danville, Norfolk, and Richmond. Voters in all localities, except Richmond, approved the casinos. The local referendum for a casino in Richmond failed in 2021, but Richmond's mayor has expressed interest in holding another referendum. Petersburg's leadership has expressed interest in authorization for a Central Virginia casino moving from Richmond to Petersburg.

The Virginia Lottery was established in 1987 and offers games of chance for sale across Virginia. Lottery is responsible for both operating and regulating lottery sales. Since 2020, Lottery has also regulated sports betting and casino gaming. Lottery has licensed and is responsible for regulating 13 sports wagering online platform operators. Lottery has licensed one casino so far (Bristol) and will be responsible for licensing at least three more (sidebar).

The Virginia Lottery Board is a seven-member citizen board. The governor appoints the members, and one member must be a certified public accountant and one member must be a law enforcement officer. The board is responsible for issuing regulations related to the lottery, sports betting, and casinos and monitoring Lottery's sales and regulatory activities.

The Lottery's two primary functions operate separately. One division develops lottery products and operates the state lottery, which employs 279 people (Figure 1-7). Operating costs related to the sale and regulation of lottery tickets are funded from lottery sales proceeds and must not exceed 10 percent of total annual estimated gross revenues. Even though operations are funded from lottery proceeds, Lottery still receives a budget appropriation to authorize its spending. In FY23, that appropriation was about \$164 million.

The other function of the Lottery is to regulate commercial gaming, which includes casinos and sports wagering. Lottery currently employs 62 people to regulate sports betting and casino gaming, and expects to hire 79 additional staff for gaming compliance as additional casinos open. In FY23, Lottery's appropriation for regulating casinos and sports betting was \$23 million. Lottery's casino and sports betting regulatory activities are funded by proceeds from licensing and related fees paid by casino and sports betting operators.

OCRP has regulated charitable gaming since 2008. OCRP is responsible for issuing charitable gaming regulations, issuing and renewing licenses, and inspecting and auditing charities. Until recently, charitable gaming was governed by an 11-member charitable gaming board, which operated as a policy board responsible for issuing regulations related to charitable gaming (sidebar). In 2022 the General Assembly enacted legislation that converted the charitable gaming board to a nine-member advisory board and transferred responsibility for issuing regulations to VDACS. OCRP currently employs a staff of 11 auditors and inspectors dedicated to charitable gaming regulation. OCRP has a budget of \$2.1 million, which comes from a general fund appropriation. However, charities pay permitting, audit, and administration fees that are intended to cover the cost of regulation.

Horse race wagering was legalized in 1988 and is regulated by VRC. The governor appoints the five members of VRC. The commission hires the executive secretary, who acts as the agency head for the VRC. In FY23, the VRC had a budget of \$4.6 million, which was an increase over previous years (sidebar). The VRC has four full-time employees (including the executive secretary). The VRC also employs a part-time HHR specialist and hires additional seasonal employees during the live racing season. VRC's operations are funded by proceeds from horse race wagering taxes.

Unregulated electronic gaming machines continue to operate in Virginia

In addition to the legal and regulated forms of gaming, an estimated 9,000 gray machines continue to operate in Virginia. Gray machines are slot-machine style electronic games that have appeared at restaurants, gas stations, and convenience stores around the state and are unregulated in Virginia. The name "gray machines" refers to the notion that the machines operate in a gray area of the law where they are neither legal nor illegal and operate untaxed and unregulated (sidebar).

In 2020, the governor and General Assembly legalized gray machines for one year to generate proceeds for a special COVID-19 relief fund. During that time, the Virginia Alcoholic Beverage Control (ABC) regulated gray machines, and each gray machine distributor was required to pay the Department of Taxation \$1,200 per machine each month in taxes. Ultimately, tax revenue from gray machines generated \$109 million in revenue, which was used to provide \$76 million in direct aid to public education, \$2

A 2021 State Inspector General (OSIG) report found that some requirements to serve on the Charitable Gaming Board created inherent conflicts of interest for some members of the board.

VRC's appropriation was increased from \$1.7 million in FY22 to \$4.6 million in FY23 to allow it to hire two additional full-time employees for HHR regulation and additional seasonal employees to regulate live racing.

The 2019 JLARC report, *Gaming in the Commonwealth*, recommended that the **General Assembly consider regulating gray machines** to ensure gaming integrity, protection to consumers, protection to businesses hosting the machines, and minimization of adverse impacts to Virginia's existing authorized gaming.

million in legal aid services for Virginians facing evictions, and \$25 million in Rebuild Virginia Grants to small businesses.

After one year, on July 1, 2021, a ban on gray machines took effect. However, in December 2021 a circuit court judge issued a temporary injunction on the ban because of a lawsuit filed by a company that hosted gray machines at several truck stops. The machines continue to operate unregulated throughout the state. The court is expected to rule on the lawsuit challenging the ban in November 2022. At the time this report is released, the court will not have ruled on the ban.

2 Creating a Central Gaming Agency

Gaming regulation is essential to protect consumers and the states and communities that host gaming facilities. Effective gaming regulation ensures that games are fair and conducted according to applicable rules, creates a safe gaming environment, promotes responsible gaming, and ensures that the state and other beneficiaries receive all gaming revenues to which they are entitled (sidebar). Gaming that is fair and safe allows players to confidently participate in legal gaming and provides credibility to gaming operators. Gaming that is unfair or unsafe not only harms individuals, but can lead to industry failure if the industry's poor reputation prompts declining participation by the public.

Governments typically carry out gaming regulation in two ways: by licensing gaming operators, manufacturers, and personnel to prevent bad actors from participating in gaming operations and by enforcing the laws, rules, and regulations that apply to each form of gaming. Regulation should be tailored to address the risk each form of gaming presents to avoid overly burdensome and unnecessary regulation; should be thorough and follow best practices to protect the public and maintain integrity; and should be carried out by government entities and staff that understand and prioritize gaming operations, their benefits and risks, and the actions and policies that constitute effective regulation.

The 2019 JLARC report *Gaming in the Commonwealth* recognized the need to evaluate the efficiency and effectiveness of Virginia's approach to gaming regulation after newly legalized forms of gaming were operational:

Moving all forms of gaming in Virginia under a single agency umbrella should be considered but not until the scale and regulatory demands of any newly authorized gaming are understood.

An incremental approach to consolidating all of Virginia's gaming under one regulatory structure would allow the gaming oversight function to be established and stabilized.

Some states consolidated gaming regulation as gaming expanded

In most states, gaming regulation appears to have developed on an ad-hoc basis as different forms of gaming were permitted in the state, similar to how Virginia has developed its structure for gaming regulation. Many states operate stand-alone gaming agencies for each form of gaming, or they place gaming responsibilities in several different state agencies where the gaming regulatory function is not the agency's primary function (sidebar). However, some states, especially states that have expanded the types

“The goal of regulators of this industry should be to ensure the integrity of gaming and to assist the collection of tax money for the state.”

– Gaming expert

Other goals of gaming regulation include 1) protecting vulnerable individuals from problem gambling, 2) stimulating job growth and economic development, and 3) preserving free market competition.

Virginia has not consolidated gaming regulation since expanding the scope of legal gaming. Other states with little to no consolidation include: Delaware, Kentucky, Maryland, Minnesota, Pennsylvania, and West Virginia.

and scope of permitted gaming, have consolidated regulation for at least some types of gaming into specialized gaming agencies.

In at least two states, Michigan and New York, gaming regulatory functions were consolidated after different forms of gaming were legal for several years, and state policymakers sought to streamline and improve the effectiveness of regulatory efforts. Michigan used an incremental approach to combining oversight responsibility for multiple forms of gaming. The Michigan Gaming Control Board was created in 1997 for oversight of newly introduced commercial casino gaming. The board developed its oversight of casinos, proved its effectiveness, and was later given oversight responsibility for horse race wagering (2010) and some types of charitable gaming (2012).

In New York, policymakers consolidated gaming regulation into a single state agency right before it authorized commercial casinos. The state combined the New York State Racing and Wagering Board, which regulated horse racing and charitable gaming, with the New York Lottery. The following year, the state authorized casinos to be regulated by the newly combined New York State Gaming Commission. As new forms of gaming have been authorized, such as fantasy contests and sports wagering, their regulation has been assigned to the State Gaming Commission because it provides a natural home for regulation of any newly authorized gaming types.

In some states, one agency regulates similar types of gaming, while other entities regulate more specialized gaming. For example, in both Indiana and Ohio, horse racetracks are permitted to have electronic gaming terminals. In both of these states, a racing commission regulates horse racing and traditional pari-mutuel wagering on horse races. However, a separate gaming agency with more expertise in commercial gaming regulates the electronic gaming terminals at racetracks—the Indiana Gaming Commission regulates slot machines at Indiana racetracks, and the Ohio Lottery regulates video lottery terminals at Ohio racetracks. In another example, Texas regulates charitable gaming through its lottery agency, while horse racing and traditional pari-mutuel wagering on horse racing is regulated through a racing commission. In Massachusetts, the Massachusetts Gaming Commission regulates casinos and horse racing, and the lottery agency sells lottery products and regulates charitable gaming.

Regulation of HHR and charitable gaming needs to be strengthened, but giving responsibility to VRC and VDACS may not be best solution

VRC's and VDACS's regulation of gaming is detailed in chapters 3 and 4.

The types of gaming regulated by the Virginia Racing Commission (VRC) and the Virginia Department of Agriculture and Consumer Services (VDACS) have grown more over the past three years than other forms of legal gaming. Wagering regulated by VRC increased nearly fivefold between 2018 and 2021 because of the introduction of historical horse racing (HHR). Wagering on charitable gaming increased approximately 50 percent between 2018 and 2021 because of the growth in wagering on electronic pull tab machines.

VRC's and VDACS's regulation of HHR and charitable gaming, respectively, are under-resourced. Both agencies need more staff and better technology to effectively regulate gaming and ensure that all gaming operates with integrity. VRC needs additional regulatory requirements for HHR, as well as compliance monitoring policies and processes for HHR.

One approach to strengthen regulation of HHR and charitable gaming would be to adequately resource VRC and VDACS and direct VRC to fully develop an adequate regulatory program. However, this approach would likely have significant challenges. The regulation of large-scale gaming activities and operators is not within the core missions of VDACS or VRC. In addition, expanding the regulatory efforts to the scale necessary could be detrimental to the performance of their core responsibilities. Given these challenges and the benefits of consolidating the regulation of most forms of gaming under a single agency (discussed in the next section), establishing a single gaming agency is the most efficient and effective approach for providing the needed regulation of all forms of gaming.

Single gaming agency benefits include prioritization of gaming, greater expertise and efficiency, and a more robust response to problem gambling

A central gaming agency can focus on gaming regulation as a primary mission and more readily develop the expertise to understand and react appropriately to the rapidly changing gaming industry. Gaming regulation is not the primary mission or focus of either VRC or VDACS. VRC's primary mission is to promote, sustain, and grow Virginia's native horse racing industry. VDACS's missions are to promote growth of Virginia agriculture, provide consumer protection, and encourage environmental stewardship. Regulating charitable gaming is a minor function for VDACS.

A central gaming agency would concentrate regulatory staff's knowledge and understanding of the gaming industry in one place. Over time, these staff should become a group of highly skilled employees specialized in effective gaming regulation. While gaming agency staff would acquire expertise in specific gaming formats, working at one agency where regulation of gaming is a core mission would facilitate staff's ability to share knowledge, experiences, ideas, and successful practices with one another. Over time, this would elevate the abilities and expertise of all staff and facilitate cross training in the regulation of more than one form of gaming. Cross training could ensure the most efficient use of staff over time, particularly if gaming expansions necessitate more frequent inspections or audits and leads to growth in licensure workloads.

A central gaming agency would also provide some ability to streamline the information technology (IT) component of gaming regulation. For example, as the operation and play of gaming becomes more electronic in nature, electronic systems become the most efficient and effective means of monitoring and auditing gaming, especially HHR

machines, electronic pull tab machines, and slot machines. This requires a significant IT infrastructure investment, which could be made most cost effectively by a single agency versus duplicating procurement and staffing costs across multiple agencies.

A central gaming agency would also better ensure that the state's problem gambling prevention and treatment efforts are robust, consistent, and coordinated. Despite the rapid expansion of gaming activities over the past few years, Virginia's problem gambling prevention and treatment efforts have not been appropriately prioritized. The Department of Behavioral Health and Developmental Services (DBHDS) is the state's lead agency for problem gambling prevention and treatment, but it depends on the three state agencies responsible for gaming regulation to make the public aware of problem gambling prevention and treatment resources and to ensure that gaming operators comply with the state's requirements on responsible gaming. DBHDS has established a stakeholder group with the gaming regulatory agencies and the Virginia Council for Problem Gambling. However, VRC has not actively participated with the group. Additionally, other states typically include gaming operators in broad problem gambling prevention and treatment efforts, but operators are not engaged in the Virginia stakeholder group. A central gaming agency would facilitate coordination among the state's regulatory staff, gaming operators, and DBHDS.

A central gaming agency would also provide lawmakers with a logical "home" for regulating any future forms of legal gaming (e.g., gray machines, online casinos, virtual reality-based gaming).

Virginia Lottery could serve as central gaming agency

Prior to 2020, the Virginia Lottery was an independent enterprise agency that only sold lottery products to raise funds for K–12 public education. Legislation enacted in 2020 expanded Lottery's scope to include regulating casinos and sports wagering. Lottery created a new division within the agency and hired staff with experience regulating gaming in other states to design and build the new regulatory function. Today, Lottery operates two distinct divisions: (1) an enterprise division that continues to develop and sell lottery products to raise funds for public education and (2) a regulatory division that establishes and enforces regulations governing the conduct of Virginia's casino and sports wagering industries (sidebar). This separates its enterprise function from its regulatory function. Lottery's regulatory practices for casino gaming and sports wagering are aligned with industry standards.

Lottery's casino and sports betting licensing requirements, processes, and staffing are thorough and consistent with industry standards. JLARC's 2019 gaming report identified industry standards for licensing and regulating casinos (sidebar, next page). These standards recommend that 1) licensing be arranged in a risk hierarchy so that the few individuals exercising the most control are subjected to the highest degree of scrutiny, 2) the licensing process include both criteria that would automatically disqualify an

JLARC staff did not perform a full evaluation of Lottery's regulation of casinos and sports wagering for this study, because Lottery is still establishing its regulatory program. JLARC staff did compare Lottery's regulatory requirements, policies, and staffing to industry standards for regulating sports wagering and casinos.

Government agencies may perform "enterprise" functions, which are business-like functions to sell a product or service. Virginia Lottery and Virginia Alcohol Beverage Control Authority (ABC) are two state agencies that perform both an enterprise function (selling lottery products for Lottery and selling alcoholic beverages for ABC) and a government function (regulating casino and sports wagering for Lottery, and regulating sales and serving of alcoholic beverages and enforcing the Commonwealth's alcohol laws for ABC).

applicant and criteria that would allow the regulators to use their judgment, and 3) a sufficient number of professional staff with backgrounds in business administration and criminal justice conduct licensing. Lottery's gaming operations division has implemented licensing procedures and taken steps that meet these standards, including conducting broad and thorough financial and criminal investigations of key gaming operator executives; conducting narrower criminal investigations of lower-level gaming employees; and hiring an adequate number of investigators with experience in law enforcement and gaming.

Lottery's compliance practices are also thorough and consistent with industry standards. These standards include establishing and enforcing policies governing 1) day-to-day operations, 2) financial audits and accounting, and 3) technology to ensure gambling devices operate properly. Lottery's gaming compliance division implemented compliance procedures that meet these standards, including hiring sufficient on-site compliance and audit staff, procuring a central monitoring system for slot machines, and promulgating extensive regulations about how casino wagering will operate.

Flexibility as an independent agency allowed Lottery to quickly build staffing and implement regulations for casinos and sports wagering

As an independent agency, Lottery was able to quickly build a regulatory framework and expand staffing levels and expertise after the 2020 legislation that legalized sports wagering and casino gaming. After the legislation became effective, Lottery issued sports wagering regulations within three months and casino regulations within eight months. Lottery issued the first sports wagering permits within six months, and the first casino license was issued in just under two years. Some other states have taken significantly longer to issue initial permits and licenses for commercial gaming (sidebar).

Independent agencies are not subject to the requirements of the Virginia Public Procurement Act, the Personnel Act, or the Virginia Information Technology Access Act. Independent agencies' flexibilities, particularly around human resources and procurement, may have helped Lottery quickly scale up to regulate commercial gaming. For example, Lottery was able to quickly recruit skilled gaming professionals from out of state because of flexibilities in their compensation policies. Additionally, not being subject to the same procurement requirements as executive branch agencies allowed Lottery to directly purchase the same gaming licensing system Maryland uses.

Lottery's licensing IT system could expand to include other gaming, and staff expertise could help procure new IT regulatory systems

Lottery has purchased and maintains a licensing system for casinos and sports wagering, which could be modified to license operators of other forms of gaming, as well as vendors and other individuals or entities. This system allows applicants to submit their application materials electronically, and it allows Lottery employees to process the application digitally. Additionally, Lottery's existing gaming technology compliance

In JLARC's 2019 study, Gaming in the Commonwealth, JLARC staff conducted a review of casino gaming laws in other states and analyzed proposals to expand legalized gaming in Virginia.

Tennessee took close to a year and a half to issue sports wagering permits—sports wagering was legalized in May 2019, and the first permits were issued in September 2020.

Maryland has not issued any permits for mobile sports wagering, which was legalized in May 2021.

employees already have some knowledge of the variety of non-Lottery gaming systems and terminals that operate in Virginia. Finally, Lottery has experience contracting for and supporting a satellite-enabled “distributed gaming system” that links lottery sales systems at each retailer to the agency’s central gaming system. Using such a system for other forms of gaming—like gray machines (if the General Assembly chose to permit them)—could improve how effectively the state monitors these other forms of gaming.

Lottery’s mission and expertise make it best positioned to become Virginia’s central gaming agency

Virginia Lottery is the best positioned state agency to serve as Virginia’s central gaming agency for several reasons. Lottery has relevant expertise in gaming regulations, and JLARC staff did not identify any indications of problems with their operations. For example,

- over the past two years Lottery transformed from an enterprise agency with the sole mission of selling lottery products to an agency with a second core mission to regulate gaming and has demonstrated its ability to keep government regulatory and enterprise functions separate;
- Lottery recently implemented a regulatory framework for casinos and sports wagering that reflects industry standards; and
- Lottery has a licensing system that is capable of being modified to regulate additional forms of gaming.

RECOMMENDATION 1

The General Assembly may wish to consider amending §58.1-4003 of the Code of Virginia to designate the Virginia Lottery as the state’s central gaming agency and rename the agency Virginia Lottery and Gaming.

An alternative option to designating Lottery as the state’s central gaming agency would be to create a new agency responsible for regulating all forms of gaming, including charitable gaming, HHR, casinos, and sports wagering. This option has several drawbacks. Lottery has already begun regulating sports wagering and casinos, and Lottery has hired nearly half of the employees needed. Creating a new state agency to regulate all forms of gaming would create disruption and uncertainty for over 60 existing employees already engaged in gaming regulation at Lottery. Additionally, creating a new gaming regulatory agency would require establishing a new leadership structure for the agency. Lottery, however, already has an existing leadership team that could manage the regulation of additional forms of gaming. Lottery may require additional staff for central services functions, such as human resources, finance, legal, and IT, if it were to become the state’s central gaming agency, but Lottery would not need as many staff for these functions as a new agency.

Central gaming agency could help respond to emerging gaming trends and technologies

Responding to the rapidly evolving gaming industry—and the risks and benefits that it poses to state and local governments and the public—has proven challenging for policymakers. Virginia could benefit from establishing a state policy office responsible for conducting ongoing policy research and building expertise on these topics. New and emerging gaming trends and technologies can affect existing legal forms of gaming, which the state, localities, and other stakeholders (e.g., charitable organizations and the horse industry) benefit from financially. Even the legal forms of gaming and the technology associated with them will continue to evolve. A small policy office employing at least one full-time employee reporting to Lottery’s executive director could be created and tasked with monitoring the gaming industry for new developments, trends, technologies, and types of gaming. This office could be established at Lottery even if no changes are made to the state’s current approach to gaming regulation. This office could issue regular reports to the General Assembly about emerging gaming trends and potential actions policymakers and other state officials could take to respond to them and to continually improve gaming regulation.

RECOMMENDATION 2

The General Assembly may wish to consider including language in the Appropriation Act directing the Virginia Lottery to establish a gaming policy office that will monitor new developments, trends, technologies, and types of gaming as well as unregulated forms of gaming and provide research and policy support to policymakers on issues related to gaming regulation.

When gray machines were first introduced to Virginia, very little was known about them by state agencies, leadership, or legislators. A gaming policy office could have provided research and policy support to legislators as they determined how to best address the introduction of gray machines to the state.

3 Regulating Wagering on Horse Racing

Until 2018, in Virginia, “horse race wagering” referred to wagering on live horse races that occurred in Virginia or were simulcast to Virginia from another state. To regulate live horse racing, a seasonal sport, the Virginia Racing Commission (VRC) needed a small staff with expertise in horse racing and animal welfare to ensure that horse races were safe and fair and to manage a relatively small amount of wagering.

Virginia’s horse racing industry was in decline until the General Assembly approved historical horse racing (HHR) to finance live horse racing. HHR now makes up 95 percent of horse race wagering and generated approximately \$19 million for Virginia’s horse industry in the last year alone. Other wagering on horse racing (wagering on live and simulcast races and advance deposit wagering [ADW]) generated about \$11 million for the horse industry over the same time frame—or approximately 35 percent of total contributions to the horse industry.

With the introduction of HHR, VRC is now responsible for regulating year-round casino-style gambling that does not resemble live horse racing in any way. To regulate HHR, the VRC needs expertise in managing the risks associated with high-volume, commercial, electronic gaming.

HHR carries most of the same risks as casinos, and wagering is near what is projected for casinos

In 2018, the General Assembly legalized historical horse racing machines to generate revenue to support Virginia’s live horse racing industry. Currently, Colonial Downs is the only licensed HHR operator in the state, and VRC regulates HHR. Since it was introduced in Virginia in 2019, HHR wagering has expanded rapidly. Colonial Downs has opened six HHR gaming facilities, known as Rosie’s Gaming Emporiums, with two additional facilities under construction. HHR wagering now makes up 95 percent of all horse race wagering in Virginia, is equivalent to the amount of wagering on lottery products, and is approaching the amount of wagering projected for casinos.

In Virginia, slot machines are legal only in casinos, but HHR machines are nearly identical to slot machines from a player’s perspective (Figure 3-1). VRC staff, the HHR operator, and gaming experts emphasized this throughout the study noting that it is “viable” to put “an HHR machine on a casino gaming floor,” that they “run these HHR locations just like they would run a casino with just slot machines,” and that they could “make [Rosie’s] look, feel, and function like a casino,” which they “already kind of do.” Rosie’s advertisements, clearly alluding to slot machines, state that the HHR machines “play, spin, and feel like the games you know and love.”

CASE STUDY

No clear difference between an HHR machine and a slot machine from a player’s perspective

In the context of horse racing, to “handicap” means to assess a horse’s winning potential based on its past performance.

In August 2022, JLARC staff visited the Rosie’s Gaming Emporium in Richmond to learn how HHR machines function from a player’s perspective. Staff observed that nothing on the machines or in the facility signified that the machines were HHR machines rather than slots. In addition, JLARC staff found it difficult to play the machines differently than slot machines. The three games staff played all defaulted to “automatic handicapping,” meaning that the games play as games of chance, exactly like slot machines. JLARC staff also found it difficult to enable manual handicapping and see the statistics on the historic horse races the games’ odds were based on. To engage manual handicapping, players must find and select a touch-activated, gray, one-by-three inch horse icon at the very bottom left corner of a colorful, approximately two-by-three foot screen.

FIGURE 3-1
Historical horse racing machines mimic slot machines

	HHR machines at Rosie’s, Richmond	Slot machines at Hard Rock, Bristol
Sounds, colors, lights	✓	✓
Spinning reels	✓	✓
Seating at machines	✓	✓
Multiple game options	✓	✓
Variable jackpots	✓	✓

SOURCE: JLARC synthesis of information provided by Lottery, VRC, and other interviewees. Slot machine picture courtesy of the Virginia Lottery.

HHR facilities strongly resemble casino gaming floors. HHR facilities have restaurants and bars and offer live entertainment, and the new facility under construction in Dumfries will be attached to a hotel. The HHR facilities, therefore, carry similar risks to

consumers and the state as casinos. Those risks include money laundering, racketeering, machine malfunctions, theft and embezzlement, and problem gambling.

In addition to the potential for financial crimes, the gaming environment can increase the risk for crimes such as drug use and sales, human trafficking, and assault (sidebar). While some risk is inherent in any gaming, certain factors increase risk (Table 3-1). Some of those factors include how easily consumers can access gaming, the pace of a game, and whether or not a gaming facility offers amenities that allow consumers to stay in the gaming environment for extended periods of time (i.e., restaurants, bars, hotels). HHR shares most of these risk factors with casinos.

TABLE 3-1
Horse race wagering now shares many risk factors with casinos

Gaming characteristics	Increases risk for:	Casinos	Horse racing	
			Pre-HHR	Post-HHR
High wagering amounts	Money laundering and other financial crimes; theft; fraud; cheating	\$4,500M ^a	\$181M ^b	\$3,400M
Available throughout the state	Problem gambling	✓	✓	✓
Offers electronic gaming terminals	Problem gambling; money laundering and other financial crimes; theft; fraud; cheating	✓		✓
Offers table games	Cheating; theft	✓		
Offers dining, entertainment, or is attached to a hotel	Problem gambling; ancillary crimes	✓		✓
Offered online statewide	Problem gambling		✓	✓

SOURCE: JLARC staff analysis.

NOTE: Adjusted for inflation. ^a Amount is estimated based on projections developed by The Innovation Group for JLARC's 2019 study, *Gaming in the Commonwealth*. ^b Represents wagering in 2013, the last year of live racing in Virginia before Colonial Downs closed. The track reopened in 2018 with the introduction of HHR.

Money laundering is using a financial transaction scheme to conceal the origins and identity of money obtained from an illicit source.

Racketeering refers to activities that disguise illegal, profit-generating activities as legitimate business deals.

In the context of gambling, crimes such as drug use and sales, human trafficking, and assault are often referred to as “ancillary crimes,” since they do not involve gambling, but may be more likely to occur in an environment where gambling takes place.

VRC's licensing program does not require adequate scrutiny of the HHR operator application

The regulatory requirements gaming operators must meet to qualify for a state license should reflect the risk and potential profit of the enterprise. Since HHR facilities and casinos carry similar risks and yield similar profits, casino licensing standards are generally appropriate for HHR facilities. However, VRC's licensing requirements and processes were designed to address the risks associated with a live racing industry that involves pari-mutuel wagering on live and simulcast horse races at the track and off-track-betting (OTB) facilities. These requirements and processes have not been modified since the introduction of HHR. VRC continues to license Colonial Downs, which operates Rosie's facilities, using the same regulatory standards that were in place when

Peninsula Pacific owns Colonial Downs and all Rosie's Gaming Emporiums in Virginia. **Colonial Downs Group**, a subsidiary of Peninsula Pacific, operates Colonial Downs and all Rosie's Gaming Emporiums, which includes live racing, off-track betting, and historical horse racing. Colonial Downs Group holds what VRC calls a "significant infrastructure limited license" that permits it to own and operate live racing and pari-mutuel wagering facilities in Virginia. This license is most similar to what the casino industry calls an "operator's license," and will be referred to as such in this chapter.

VRC recently approved a transfer of ownership of its racing and betting facilities from Peninsula Pacific to **Churchill Downs**, but the transfer was not complete when this report was published.

Financial crimes are difficult to identify because criminals may have worked extensively to hide assets and financial interests or launder their illegal profits through various legitimate businesses. Without complete information on an individual's finances, identifying crimes after they have occurred is difficult.

Colonial Downs operated only live race tracks and off-track betting facilities (sidebar). As a result, VRC's licensing process does not address HHR-specific risks, such as the heightened risk for theft, money laundering, and problem gambling (sidebar). While HHR wagering is technically considered pari-mutuel wagering, it has a larger volume of wagering, and customers play at electronic gaming machines that mimic slot machines.

JLARC's 2019 report, *Gaming in the Commonwealth* identified best practices for licensing casinos. Those best practices include 1) licensing key executives, gaming suppliers, and employees, 2) arranging licensing requirements in a risk hierarchy, 3) verifying information submitted in license applications through investigations, and 4) conditioning operator license issuance on compliance with rules for casino operation. VRC has not developed HHR licensing standards through regulation or policy that meet best practices (Table 3-2).

TABLE 3-2
VRC lacks key licensing requirements for HHR facilities

Key licensing best practices	Lottery	VRC	Explanation of VRC shortcomings
Extensive licensing requirements for key executives, owners, and individual employees who control the casino business operation, including operations and security managers.	●	①	Operations and security managers not considered key executives, subject to lesser licensing requirements.
Licenses required for gaming suppliers, businesses, or individuals who design, manufacture, or sell gaming equipment or software.	●	①	Insufficient information required of suppliers.
Licenses required for individuals employed by the gaming operator.	●	●	Licenses required for individuals employed by the gaming operator.
Detailed personal and financial information required in key executive applications.	●	①	Insufficient information required of executives.
Information submitted in licensure application required to be verified through investigation for all employees.	●	①	Criminal background checks required, but personal and financial information submitted in licensure applications not required to be verified.
Gaming establishment required to meet certain operational standards, such as development of internal controls, before it can receive its license.	●	①	HHR facilities not required in regulation to meet any pre-opening requirements.

SOURCE: JLARC summary of licensing requirements from Virginia Lottery and the Virginia Racing Commission.

Lottery's casino licensing requirements conform to best practices. When a potential casino operator applies to the Virginia Lottery, all key executives, gaming suppliers, and employees must submit to background investigations of varying depth. For the highest level employees, such as vice presidents of operations, that includes an in-depth personal and financial investigation designed to verify all information in an application and uncover any relevant information applicants may not have disclosed. During this process, Lottery's team of 25 investigators spends up to a year analyzing each applicant's financial transactions; interviewing the applicants' friends, family, and

co-workers; and investigating any lawsuits involving applicants, among other activities (sidebar). For the lowest level employees, such as food service employees or janitorial staff, the investigation would include a criminal background check, but no personal or financial investigation. Once investigations are complete, operators must meet certain conditions, such as demonstrating that their internal controls comply with the law, before Lottery issues their license.

State law provides Lottery with up to one year to conduct its licensing investigations for casinos. According to Lottery staff, most investigations take one year to complete.

In contrast, VRC has not developed regulations or policies to meet best practice standards for licensure of HHR facilities. VRC is not required to and does not make key managers (e.g., facility managers, surveillance and security managers) submit more information in their license application than other employees. Further, though key *executives* are required to submit more information than other employees in their licensing applications, VRC is not required to and does not independently verify any financial or personal information that applicants submit, beyond conducting a criminal background check. In addition, VRC is not required by law to collect—nor has it established regulations to collect—sufficient information from gaming equipment suppliers when issuing supplier licenses. Finally, though VRC staff reportedly walk through a new HHR facility before it opens, there are no formal pre-opening requirements or conditions for facilities to receive a license.

To ensure that their licensure process is thorough enough to deter and/or identify bad actors or insufficiently qualified executives, HHR licensure regulations should include the same key requirements as the casino licensure regulations. The regulations should 1) require HHR managers, gaming suppliers, and employees to submit to a personal, financial, and criminal background investigation; 2) require the regulatory agency to conduct more thorough investigations for individuals with the most control over the HHR operations; 3) require the regulatory agency to verify application information and ensure that the agency has the necessary authority to do so; and 4) require the operator to meet clear terms and conditions before being issued a license to open a facility.

RECOMMENDATION 3

The General Assembly may wish to consider amending the Code of Virginia to require the agency responsible for regulating historical horse racing (HHR) to promulgate regulations for licensing the HHR operator, suppliers, and employees that incorporate established best practices for the licensure of casinos. Regulations should, at a minimum 1) subject individuals with the most control over HHR operations, including facilities' managers, to the most scrutiny, including personal, financial, and criminal background investigations; 2) require the regulatory agency to conduct thorough criminal, financial, and personal background investigations and verify information provided in licensure applications; and 3) require the HHR operator to meet certain conditions before receiving a license to open a facility.

Lottery considers an entity a **supplier** if it sells gaming supplies to a casino.

Lottery considers an entity or individual a **vendor** if it sells non-gaming supplies or services to a casino.

State law sets the \$15 million licensing fee charged to casino facilities, \$50,000 licensing fee charged to principals, and \$5,000 licensing fee charged to suppliers.

State law allows Lottery to set the application fee for employees and vendors, which it has set at \$500.

Lottery's thorough licensing process necessitates higher licensing fees and a lengthier licensing process for casinos, compared with the fees and timeline at VRC. VRC currently charges the operator \$1,000 per HHR facility and charges individual applicants \$30 to cover the cost of their criminal background check. VRC's regulations do not stipulate the amount of time the agency has to issue a license for an HHR facility, but staff report that application review takes one month. Conversely, Lottery charges operators \$50,000 per principal employee plus a \$15 million casino facility licensure fee, charges suppliers \$50,000 per principal employee plus a \$5,000 application fee, and charges vendors and employees \$500 (sidebar). By law, Lottery has up to a year to make licensure decisions for a casino facility. Licensing takes less time for other licenses.

If the General Assembly directs the agency responsible for regulating HHR to strengthen HHR licensure requirements, it should also adjust required licensure fees to ensure that the HHR operator bears the costs of investigation and adjust licensure timelines to allow the agency to conduct thorough investigations consistent with the new licensure requirements.

RECOMMENDATION 4

The General Assembly may wish to consider amending the Code of Virginia to (i) require that licensing fees for historical horse racing (HHR) be sufficient to defray the regulatory costs of licensure and be consistent with the risks and potential profit associated with HHR and (ii) give the agency regulating HHR up to one year to license the HHR operator.

While they have not been subject to a thorough licensing process, it does not appear that any wrong-doing or noncompliance by Peninsula Pacific or Colonial Downs has occurred. The risks created by the deficiencies in licensing requirements appear to have been mitigated thus far because Peninsula Pacific is a national commercial gaming company with gaming facilities in other states. Peninsula Pacific, many of its key executives, and some key managers had undergone rigorous gaming licensing in other states, such as New York and Iowa, prior to applying for an HHR license in Virginia. Additionally, in 2021, Peninsula Pacific successfully applied for a sports wagering operator permit from the Virginia Lottery, a process that also applied appropriate levels of scrutiny to the applicants.

However, the state should not continue to rely on the goodwill and honor of gaming owners and operators and their employees who apply for licensure. Doing so creates unacceptable risks for wrongdoing and is not considered an acceptable practice in the gaming industry.

VRC lacks adequate regulatory program to ensure proper operation of HHRs and address problem gambling

To ensure that commercial gaming facilities are safe and fair, states need to promulgate regulations that establish operating standards, address risks associated with commercial gaming, and establish clear mechanisms for the relevant regulatory agency to enforce them. Casino regulations typically include rules for a casino's day-to-day operations, financial accounting, and technology. For example, a gaming agency may require a casino to develop internal controls that the agency approves, conduct random inspections to confirm that casinos are following those controls, require a casino to submit an independent yearly audit, and/or register all electronic gaming devices. Because of their similar risks, HHR facilities should be subject to similar requirements. However, VRC has promulgated only minimal regulations that govern the operation and oversight of HHR facilities and are not adequate to ensure the proper operation of HHR in Virginia (Table 3-3).

TABLE 3-3

Regulations for HHR operations do not address key risks

Key regulatory best practices for casinos	Lottery	VRC	Explanation of VRC shortcomings
Requirements for operators' internal controls for day-to-day activities, such as cash drops and payouts, which must be approved.	●	○	No requirements for internal controls.
Regulations specify requirements for software, hardware, and operations of electronic gaming terminals, like HHR or slot machines.	●	●	Regulations specify technological and mechanical requirements for HHR machines.
Inspectors required to document noncompliance identified during inspections.	●	①	Inspectors not required to document noncompliance. ^a
Required submission of independent financial audits of all facilities it oversees. ^b	●	○	No required submission of independent financial audits of HHRs.
Required supervision of the installation, start-up, and movement of electronic gaming terminals.	●	○	No required supervision of the installation or start-up of HHR machines.
Regulations establish clear methods for enforcing all operational requirements.	●	○	Regulations do not establish clear sanctions or other means to enforce HHR operational requirements.

SOURCE: JLARC summary of licensing policies from Virginia Lottery and the Virginia Racing Commission.

NOTE: ^a VRC's integrity auditor documents inspections of HHR machine technology and submits reports to the VRC executive secretary. ^b Typically includes audited financial statements, management letter (containing descriptions of significant deficiencies and material weaknesses), description of auditor's recommendations for eliminating weaknesses and deficiencies, assessment of the IT security controls, and the operator's written response and corrective action plans.

HHR regulations do not address key risks

Current HHR regulations do not address key risks associated with large-scale commercial gaming. Virginia's casino regulations require casino operators to develop internal controls that address certain items such as accounting procedures, jackpot

VRC requires the HHR operator to submit standard operating procedures as part of its license applications, and the staff have requested that changes be made to those processes upon review. However, regulations do not require this submission, and VRC staff do not verify that the procedures are implemented as written.

payouts, and count room procedures to help prevent theft and fraud. Operators must submit internal controls to Lottery along with a letter from a CPA stating that the controls are adequate, and Lottery must review and approve them before a casino can open. HHR regulations do not require the operator to develop internal controls or submit them to VRC. Lottery regulations require inspectors to document their inspections and issue a report to the casino operator. HHR regulations allow VRC staff to conduct random inspections but do not require staff to document those inspections and provide the operator with a report. Casino regulations require that operators submit yearly independent audits to Lottery for review, but HHR regulations do not. Lottery must supervise delivery and installation of slot machines at casinos, while the HHR operator can do so without VRC supervision. Finally, Lottery regulations establish a range of enforcement options that can be used to address noncompliance, ranging from requiring development of a correction plan to license suspension or revocation. In contrast, state law allows the VRC to suspend and revoke licenses and to fine a permit holder up to \$10,000; however, the HHR regulations do not provide a similar range of enforcement options for addressing noncompliance that Lottery regulations provide in the event of noncompliance.

To ensure that HHR facilities operate properly and to adequately minimize risks, regulations need to be promulgated and enforcement policies adopted that meet established best practices for casino regulations that are comparable to those developed by Lottery. At a minimum, those regulations should require the agency regulating HHR to 1) establish internal control requirements for day-to-day operations of HHR facilities; 2) require the HHR operator to submit annual independent financial audits, including the management letter (containing descriptions of significant deficiencies and material weaknesses); 3) conduct regular, formal inspections of HHR facilities and provide reports to the HHR operator on inspection findings and actions that should be taken by the operator to remedy any noncompliance; and 4) establish mechanisms that can be used to enforce the regulations, such as financial penalties or corrective action plans.

RECOMMENDATION 5

The General Assembly may wish to consider amending the Code of Virginia to require the agency responsible for regulating historical horse racing (HHR) to promulgate regulations to ensure proper operations at HHR facilities and effectively minimize risks. At a minimum, regulations should require the regulatory agency to 1) establish internal control requirements for day-to-day operations of HHR facilities, 2) require the operator to submit an annual independent financial audit, including the management letter, 3) conduct regular, formal inspections of HHR facilities to identify and remedy any noncompliance, and 4) establish mechanisms that can be used for enforcing regulations.

VRC lacks documented policies and procedures for ensuring compliance with state laws and regulations

To ensure that HHR facilities are complying with the state's laws and regulations, VRC staff need to observe and inspect HHR operations. VRC lacks documented internal policies and procedures that describe how observations and inspections should be conducted.

VRC staff conduct onsite inspections of HHR facilities, but they are infrequent and informal. VRC contracts with the Thoroughbred Racing Protection Bureau (TRPB) to conduct more formal and documented, but narrowly focused, onsite inspections of HHR facilities. The TRPB conducts just two inspections per year across all HHR facilities. Inspection reports show that the inspections focus exclusively on the functioning of HHR machines. While it is vital that HHR machines function properly, inspections should also assess whether the HHR facilities' operations are meeting other legal and regulatory requirements and the HHR facilities' internal controls. VRC staff report that they visit the HHR facilities periodically to inspect other aspects of the gaming environment, but they do not document those inspections. Further, there are no internal VRC guidelines that describe what should be included in an inspection, making it likely that inspections are inconsistent across HHR facilities. No internal VRC documentation exists on the HHR facilities' compliance with internal controls that are critical to maintaining the integrity of the gaming environment, such as preventing underage gambling or preventing individuals who have voluntarily placed themselves on the gambling exclusion list from entering the facility.

Inspections should also occur more frequently. With six HHR locations and only two formal and documented inspections per year, locations could go as long as three years without receiving a formal inspection. In contrast, charitable gaming organizations, which handle a much lower volume of cash and customers, are each inspected at least once per year, and the Virginia Lottery has 16 staff who work on location at the Bristol casino and have a presence 24 hours a day, seven days a week to ensure that the operator is in compliance with state laws and regulations. Other than its contract with TRPB requiring two machine-focused inspections per year across all HHR facilities, VRC has no internal policies describing how frequently they will conduct inspections.

The agency that regulates HHR needs to establish clear agency policies for ensuring that the HHR operator complies with all applicable laws and regulations. At a minimum, policies should establish procedures for inspecting HHR facilities, including documentation, aspects of HHR facilities and operations to be observed, and criteria that must be met for a satisfactory inspection; procedures for routine financial and operational audits; and the frequency with which these activities will be conducted.

RECOMMENDATION 6

The General Assembly may wish to consider amending the Code of Virginia to direct the agency responsible for regulating historical horse racing (HHR) to develop internal policies for ensuring the HHR operator's compliance with all applicable laws and regulations. At a minimum, the agency should establish (i) procedures for inspecting HHR facilities, observing operations and wagering at the facilities, and documenting any noncompliance; (ii) the aspects of operations and facilities to be inspected and observed and what constitutes a satisfactory inspection, (iii) procedures for routine financial and operational audits, and (iv) the frequency with which compliance activities will be conducted.

HHR needs policies that address problem gambling prevention and treatment

Virginia's Problem Gambling helpline intakes doubled between 2018 and 2019, the year HHR wagering was introduced. VRC should consider the possibility that HHR wagering is contributing to increased problem gambling in Virginia and develop actions it should be taking to mitigate problem gambling.

Finally, VRC does not appear to be participating in statewide efforts to prevent problem gambling. VRC regulations only require the HHR operator to submit a responsible gaming plan and an annual update on its implementation. According to staff working on the state's problem gambling initiative at the Department of Behavioral Health and Developmental Services (DBHDS), VRC staff have not participated in any meetings regarding problem gambling. Most horse race wagering happens on HHR machines, which, due to their similarity to slot machines, are a highly addictive form of gambling (sidebar). Research shows that the majority of players diagnosed with problem gambling play slot machines, and that slot machines lead to a faster onset of problem gambling than other forms of gaming. Reasons for slot machines' addictiveness include their accessibility (high prevalence and low starting wagers) and the immediacy of the reward.

RECOMMENDATION 7

The General Assembly may wish to consider amending the Code of Virginia to direct the agency that is responsible for regulating historical horse racing to develop policies detailing how it will participate in statewide efforts to prevent and treat problem gambling.

Three horse racing tracks operate in Virginia: Colonial Downs, Shenandoah Downs, and Great Meadows.

Rosie's has operations in New Kent, Richmond, Hampton, Vinton, Dumfries, and Collinsville. Colonial Downs has broken ground on two additional Rosie's: a second one in Dumfries and one in Emporia.

VRC lacks staff and expertise needed to effectively regulate HHR

The introduction of HHR substantially increased VRC's workload. Between 2018 and 2021, the number of facilities that host horse race wagering (whether live or HHR), and that VRC must therefore supervise, doubled. Prior to the introduction of HHR, horse race wagering took place at seven facilities, including race tracks and off-track betting facilities. Now, wagering takes place at an additional six HHR facilities, and two additional HHR facilities are being developed (sidebar). VRC is now responsible for

regulating activities at 14 facilities. With more facilities to regulate, VRC needs to conduct more inspections, ensure that more HHR machines function correctly, respond to more incidents of noncompliance, and manage more revenue.

VRC's licensing workload has more than tripled since the introduction of HHR—from 900 licenses issued in 2018 to 3,400 in 2021—and is expected to increase further. Colonial Downs anticipates that when the two new Rosie's locations open by 2024, VRC will need to license an additional 700 staff. Unless more licensing staff are hired, it is unlikely that VRC will be able to manage the additional licensing workload without creating hiring delays for the HHR operator.

VRC's staff size needs to quadruple to adequately regulate HHR

Despite the rapid expansion of the number of HHR machines and facilities and volume of wagering, VRC's only additional staffing since the introduction of HHR is a part-time HHR compliance specialist who is responsible for reviewing HHR facilities' security and operations procedures but who resides out of state. VRC has relied on the expertise of its part-time HHR compliance specialist, existing staff, and a contract with the TRPB to regulate HHR.

Aside from the part-time HHR compliance specialist, VRC has no dedicated staff to inspect HHR facilities and ensure they comply with state regulations. As a result, VRC cannot conduct frequent inspections of HHR facilities, document the inspections they do conduct, or provide technical assistance to help a facility correct noncompliance. Additionally, without gaming technology specialists, VRC is dependent on the HHR operator and the TRPB to ensure that machines are operating correctly, and they cannot independently verify this.

VRC should have increased staffing to effectively regulate HHR. Given the current scale of HHR facilities in Virginia, JLARC staff determined VRC needs at least 15 licensing, audit, compliance, and technology employees, in addition to its four existing staff (sidebar). Once the number of HHR facilities grows to eight facilities, HHR regulation will need at least 22 licensing, audit, and technology employees. This includes:

- At least five licensing employees, assuming that the HHR facilities employ approximately 1,100 employees requiring licensure. Once the number of facilities grows to eight with 1,800 employees requiring licensure, VRC will need seven licensing employees.
- At least five employees for compliance enforcement and inspections. Once the number of facilities grows to eight, seven compliance enforcement employees will be needed.
- At least two employees for conducting audits. Once the number of facilities grows to eight, four audit employees will be needed.

VRC employs only four full-time staff: an executive secretary, a veterinary manager, a director of pari-mutuels and licensing, and a director of compliance. VRC hires seasonal staff during the live racing season.

The 2023–2024 Appropriation Act authorized VRC to fill two vacant positions. According to VRC staff, they plan to hire one employee for licensing and one employee for compliance inspections. However, this is far less than the 15 employees needed.

Staffing ratios for VRC were calculated using ratios used in the 2019 JLARC report, *Gaming in the Commonwealth*, to determine staffing needed to regulate casinos.

HHR facilities are different from casinos in a few ways that reduce the risk associated with them (e.g., they do not have table games, and HHR machines are server-based), which may mean they need fewer regulatory staff than casinos. JLARC staff assumed that HHR facilities would need 10 percent of regulatory staffing necessary for casino compliance/enforcement, 50 percent of casino audit staffing, and 50 percent of casino technology staffing.

Appendix B contains a more detailed discussion of this methodology.

- At least three employees for ensuring compliance with the state’s rules on gaming technology. Once the number of facilities grows to eight, four technology employees will be needed.

VRC commissioners and staff lack relevant experience needed to regulate HHR

VRC’s leadership includes the five commissioners who are appointed by the governor, and the executive secretary who is hired by the board to act as the agency head and manage VRC’s day-to-day business.

Existing VRC commissioners and staff do not have expertise in casino-like gaming that is required to effectively regulate HHR, which has become a large-scale gambling operation. Commission members and staff have significant experience in the horse industry, agri-business, horse racing, and traditional pari-mutuel wagering, but the experience and knowledge required to ensure that a horse race is fair and safe are different from those required to monitor and secure a casino-like gaming environment. Gaming governance boards typically require members to have experience in certain fields (such as accounting, law, and law enforcement) that better enable the boards to identify regulatory compliance issues, effectively oversee the regulatory staff, and make key regulatory decisions.

When the Virginia Lottery became responsible for regulating casinos and sports betting, it hired staff with expertise to effectively oversee the new forms of gaming. For example, Lottery hired many gaming compliance staff with experience regulating casinos in Maryland. Additionally, the General Assembly expanded the Lottery Board to include two new members with accounting and law enforcement experience. Even though HHR wagering now makes up 95 percent of all horse race wagering, the only VRC staff member with relevant experience is the part-time HHR compliance specialist who works remotely from another state.

Furthermore, despite being tasked with HHR regulation, VRC does not devote a substantial portion of its meetings to HHR or demonstrate awareness of the potential for illegal activity or public harm that could be prompted by the growth in HHR’s casino-like entities. VRC meetings typically involve detailed discussions of the number of live horse racing days, racing conditions, and other matters specific to horse racing, in contrast to the less in-depth discussions of HHR gaming. JLARC staff observed the April 2022 and June 2022 VRC meetings where the change in ownership application for Colonial Downs and Rosie’s was discussed. During this discussion, VRC members mostly questioned Churchill Downs’s commitment to the horse industry and horse racing and asked few questions regarding their experience and plans for HHR wagering.

Regulation of live horse racing wagering should remain with VRC, but Lottery should regulate HHR

Regulating horse racing requires specific knowledge and expertise that is different from what is required to regulate commercial gaming, and VRC staff and commis-

sioners have the knowledge and expertise needed to regulate live racing. VRC commissioners are typically appointed because of their personal or professional interests and experience in the horse industry (for example, most members have owned horses, trained horses, or owned an agricultural business). VRC staff, both the full-time staff and the seasonal part-time staff, have highly specialized training and expertise in horse racing, animal welfare, and traditional pari-mutuel wagering. Some examples of the technical knowledge required to understand and apply the rules of horse racing and pari-mutuel wagering include:

- determining whether a horse obtained a fair start;
- recognizing instances of prohibited jockey interference;
- ensuring horses and other participants wear required equipment, such as safety helmets or horse blinkers;
- determining whether whips were used excessively;
- understanding which medications are permitted and prohibited;
- determining how and when to test horses for medications;
- directing when and how wagering should be terminated at the start of a race; and
- deciding how winning pools are distributed.

In addition, VRC was established and is resourced to regulate a sport in Virginia that has traditionally been seasonal. VRC's small size and resources reflect its responsibility to regulate racing that takes place over a relatively short period each year.

Improving regulation of HHR is necessary, but doing so at VRC would significantly change the agency's culture and mission

VRC could be staffed and resourced to appropriately regulate HHR, and its board membership requirements could be changed to ensure that board members have the expertise needed to regulate a large commercial gaming operation. However, increasing the agency's size and expanding its day-to-day responsibilities to the extent required would be difficult for this four-person agency to successfully carry out. Additionally, whereas the VRC staff and commissioners have remained mostly focused on regulating and supporting Virginia's live horse racing industry and activities, a significant amount of the staff's time and attention would need to shift to HHR. For example, the VRC would need to devote substantial time and resources to hiring the requisite licensure and regulatory compliance staff and managing the expanded licensure and regulatory compliance programs. .

Regulation of HHR should be assigned to the Virginia Lottery

Virginia Lottery's leadership is more focused on gaming regulation than VRC's leadership—it has embraced gaming regulation as one of the agency's core missions. The Lottery board already has the necessary expertise for regulating HHR, and its board

and staff already pay strong attention to and have knowledge of the complexities of regulating large-scale gambling operations. For example, Lottery board membership must include a certified public accountant and a law enforcement officer. Board meetings include detailed discussions of gaming licensing practices and statistics; layout, practices, and operations of casinos and sports wagering operators; and gaming compliance efforts. Additionally, Lottery's leadership staff, specifically in the gaming compliance division, have experience regulating commercial gaming in Virginia, as well as in other states with a longer history of gaming, such as Maryland, Pennsylvania, and Nevada.

Lottery has an agency environment and culture focused on gaming regulation, and the agency has been able to expand its gaming expertise through hiring experienced staff and providing extensive training. Lottery employees, specifically in the gaming compliance division, receive extensive training on regulating casinos and sports wagering. Many of the current employees are former law enforcement officers or worked in other states on gaming compliance, so they have an understanding of the risks associated with gaming and the necessity of mitigating those risks through regulation.

Lottery also has resources that could be used to help build and implement a better IT regulatory system for HHR. Virginia Lottery employs staff with expertise in electronic gaming machines and systems who are familiar with the various types of electronic gaming machines and systems available on the market. These staff could help determine the additional resources needed (in terms of staff, hardware, software, and contracts), to implement an IT system for HHR regulation and assist in developing the system.

Virginia Lottery could also use its existing licensing system for HHR licensing, which could allow for electronic submission of applications and documentation, automatic workflow processing, and more convenient and timely processing. VRC staff currently have to manually enter the information from hard copies into its database for HHR regulation, because the system does not allow for electronic submission or upload of licensing applications and documentation.

Some other states that, like Virginia, permit electronic gaming terminals at racetracks require the electronic games and horse races to be regulated separately. For example,

- Indiana has two racetracks that it has authorized to host slot machines. Indiana regulates horse racing and traditional pari-mutuel wagering on live and simulcast races through the Indiana Horse Racing Commission. The gaming floor and slot machines at the Indiana racetracks are regulated through the Indiana Gaming Commission (sidebar).
- Ohio regulates horse racing and traditional pari-mutuel wagering on live and simulcast races through the Ohio State Racing Commission, while the Ohio Lottery regulates video lottery terminals and gaming floors at racetracks.

The Virginia Lottery purchased its gaming licensing system from Maryland's casino regulatory agency, and Virginia Lottery's employees maintain and update the system in-house. According to Lottery staff, the system is agile and their staff could develop system modules specific to licensing for other types of gaming.

The Indiana Gaming Commission regulates casinos, sports wagering, charitable gaming, fantasy contests, and slot machines at racetracks.

No VRC staff can be transferred to Lottery to reduce the additional cost of the new function, because VRC has no full-time staff dedicated to regulating HHR. Given the current HHR facilities' size and scope, Lottery would need at least 15 additional staff and approximately \$2.2 million to adequately regulate HHR (Table 3-4). Lottery's existing gaming compliance staff could not be used to regulate HHR. These staff are needed to implement casino and sports betting regulations, and because these staff positions are funded through taxes and fees collected from casino and sports betting operators, they cannot be used to regulate HHR.

According to gaming experts interviewed by JLARC staff, HHR may require fewer enforcement staff than casinos. While similar, HHR facilities differ from casinos in ways that somewhat reduce their risks relative to casinos. HHR facilities (1) do not have table games, (2) the HHR machines are server-based rather than having a random number generator on each machine, and (3) HHR facilities host a smaller number of gaming machines than casinos (sidebar). While staffing needs for regulating HHR facilities are likely lower than those for casinos, as Lottery begins to regulate them, it should reassess their risks and determine whether additional staffing is required to adequately regulate them.

TABLE 3-4

Lottery would need at least 15 employees for HHR regulation, but more regulatory employees will be needed when two additional HHR facilities open

Function area	Existing HHR facilities		Expand to 8 HHR facilities		Average employee salary
	FTEs	Cost	FTEs	Cost	
Personnel costs (salaries plus fringes)					
Licensing	5	\$608K	7	\$851K	\$69,400
Enforcement	5	483	7	676	\$56,500
Audit	2	279	4	559	\$84,700
Technology	3	525	4	700	\$92,200
Overhead					
Non-personnel costs	-	306		450	
Total costs	15	\$2,201K	22	\$3,236K	

SOURCE: JLARC staff analysis of staffing data from other states and the Virginia Lottery.

NOTE: Average salaries are based on the actual salaries of comparable Lottery employees with 10 years or less of state service. Estimated costs for employees includes benefit costs.

HHR regulation could be funded through taxes collected on HHR and other pari-mutuel wagering on horse racing. Since the introduction of HHR, state taxes collected from pari-mutuel wagering on horse races grew from \$1.9 million in FY18 to \$31 million in FY22. VRC collects these tax revenues, uses approximately \$1.5 million to fund its operations, and reverts the remaining amount (\$29.5 million in FY22) to the general fund. As HHR facilities continue to expand, these tax collections will continue to grow. The state could fund HHR regulation at the Lottery through the state tax collections on pari-mutuel wagering, and over \$25 million annually would still revert

Casinos tend to **have more gaming options than HHR facilities**, which increases the risk associated with them.

Currently, two HHR facilities have around 500 HHR machines, two facilities have 700 machines, and the other two facilities have 37 machines and 150 machines respectively. The new Dumfries locations will host up to 1,200 HHR machines when it opens.

The temporary casino at Bristol currently hosts 870 slot machines, 22 table games, and a sports wagering facility ("sports-book"). The operator plans to host 1,500 slot machines, 55 table games, and a sportsbook in the permanent Bristol casino.

to the general fund from these tax collections. The costs of developing a more robust HHR licensing process should be fully covered by licensing fees charged to applicants and the licensed operator. Additionally, proceeds from HHR and other pari-mutuel wagering dedicated to the horse industry are taken out of gaming proceeds before state taxes, so increased regulation costs would not reduce the amount of funds that the horse industry receives.

RECOMMENDATION 8

The General Assembly may wish to consider amending Chapter 40 of Title 58.1 of the Code of Virginia to remove responsibility for regulating historical horse race wagering (HHR) from the Virginia Racing Commission and Chapter 29 of Title 59.1 of the Code of Virginia to assign regulatory responsibility for HHR to the Virginia Lottery.

If the Lottery is charged with regulating HHR, the Lottery board's membership should be modified to ensure that the interests of the horse racing industry are represented and to facilitate coordination and information sharing between the Lottery board and the VRC. The Code of Virginia should be amended to add a member of the VRC to the Lottery board as a voting ex-officio member. This would ensure that the horse industry maintains a connection to the funding source that has revitalized the industry. The VRC executive staff secretary could also serve on the Lottery Board as a non-voting ex officio member.

Implementing both recommendations 9 and 14 would increase the size of the Lottery Board from seven to nine members.

RECOMMENDATION 9

If the Virginia Lottery is given responsibility for regulating historical horse racing, the General Assembly may wish to consider amending §58.1-4004 of the Code of Virginia to add one position to the Lottery Board that will be filled by a member of the Virginia Racing Commission who will serve as a voting ex officio member.

State law provides safeguards to ensure that HHR funds continue to support the state's horse industry, regardless of regulatory structure

The General Assembly permitted HHR wagering to fund Virginia's horse racing industry, and legislators included safeguards in the law to ensure that HHR continues to benefit the horse racing industry. The Code of Virginia and VRC regulations require that the HHR operator (i.e., Colonial Downs) hold one live race day annually for every 100 HHR terminals operating in the Commonwealth (sidebar). This requirement ensures that if the operator does not hold the required number of live race days, it cannot continue to operate HHR terminals. The operator also has an agreement with the state's various horse industry associations (the "revenue sharing agreement") that requires the operator to make payments to the state's horse industry groups. These payments are calculated based on the net revenue generated by HHR machines. In addition, language in the Appropriation Act requires that a portion of HHR revenues be

The seventh enactment of Chapters 1197 and 1248 of the Acts of Assembly of 2020 required that the number of live racing days be increased by one day for every 100 additional HHR terminals authorized.

distributed to the Virginia Breeders Fund, the Virginia-Maryland Regional College of Veterinary Medicine for equine programs, the Virginia Horse Center Foundation, and the Virginia Horse Industry Board.

The legal safeguards that ensure HHR wagering benefits Virginia's horse industry should not be affected if regulation of HHR is transferred to Lottery. However, VRC should send periodic reports to the Lottery verifying that live race days were held and that they met any applicable requirements. Additionally, current language in the Appropriation Act that directs a portion of HHR revenues to various horse industry interests should be maintained even if HHR regulation becomes Lottery's responsibility.

HHR's purpose could be reiterated in the Appropriation Act

HHR's purpose, which is specified in state law, could also be detailed in the Appropriation Act. The Code of Virginia specifies that HHR wagering is authorized "for the promotion, sustenance and growth of a native industry, in a manner consistent with the health, safety, and welfare of the people." If HHR regulation is moved to Lottery, the General Assembly could add more precise language to Lottery's section of the Appropriation Act stating that the HHR facilities and machines have been authorized for the purpose of providing support and funding specifically to Virginia's horse racing industry.

RECOMMENDATION 10

If the Virginia Lottery is given responsibility for regulating historical horse racing, the General Assembly may wish to include language in the Virginia Lottery's section of the Appropriation Act stating that historical horse racing has been authorized for the purpose of providing support and funding to Virginia's horse racing industry.

HHR operator license should be contingent on being licensed by VRC for live horse racing

If Lottery is assigned responsibility for granting HHR operator licenses, granting an HHR operator license should be conditioned on VRC *first* granting the operator a significant infrastructure limited license for live racing, which the operator needs to hold live horse racing in Virginia. If VRC determines that the operator is not fulfilling its live racing responsibilities or that the operator is not compliant with live racing regulations, this condition would ensure that VRC can prevent the operator from conducting HHR in Virginia even if HHR is no longer licensed and regulated by VRC. This condition for licensure would ensure that—regardless of which state entity regulates HHR operations—HHR continues to operate for the benefit of Virginia's horse industry and live horse racing, which was the General Assembly's original purpose for authorizing HHR.

RECOMMENDATION 11

If the Virginia Lottery is given responsibility for regulating historical horse racing, the General Assembly may wish to consider amending §59.1-375 of the Code of Virginia to require that the historical horse racing operator have an active significant infrastructure limited license from the Virginia Racing Commission to be eligible to obtain a license from the Virginia Lottery to conduct historical horse racing.

4 Regulating Charitable Gaming

Charitable gaming exists to help charitable organizations raise revenue for charitable purposes. Though charitable gaming operates on a smaller scale than other forms of legal gaming in Virginia, state regulation is necessary to ensure the integrity of charitable gaming operations and that charitable gaming is fulfilling the purpose authorized by the legislature. Charitable gaming carries less risk than HHR wagering and casino wagering because of the smaller amounts wagered at charitable gaming events. (In 2021, the average annual wagering at organizations sponsoring charitable gaming was less than 10 percent of the average wagering per HHR facility and what is projected for a single casino in Virginia.) However, wagering on charitable gaming averaged \$5.4 million per organization in 2021, a significant amount for organizations that are relatively small and whose gaming operations typically are staffed by inexperienced volunteers, necessitating guidance and regulation from the state.

VDACS has too few staff to oversee charitable gaming operations and use of proceeds

Recent changes to state law have substantially increased the state's role in regulating charitable gaming, which is the responsibility of the Virginia Department of Agriculture and Consumer Services (VDACS). In 2022, state law was amended to change the Charitable Gaming Board from a policy board to an advisory board, which transferred authority for regulating charitable gaming activities from the board to VDACS staff. Changes to state law also gave VDACS oversight and enforcement authority for wagering on electronic pull tabs in charitable organizations' social quarters (sidebar), which constitute about 90 percent of all charitable gaming wagering. This represents a significant expansion of VDACS's authority because staff previously could not take any actions against charitable organizations to enforce gaming regulations without the board's approval. For example, staff had to receive approval from the board before denying, suspending, or revoking charitable gaming permits, but staff will now be able to take such actions without board approval.

OCRCP has not had sufficient staff to effectively regulate charitable gaming for several years, nor is it staffed to fulfill its expanded role

VDACS's expanded authority will increase staff's workload in its Office of Charitable and Regulatory Programs (OCRCP), which will exacerbate its current staffing shortage. One of the key findings of a 2021 review of charitable gaming by the Virginia Office of the State Inspector General (OSIG) was that OCRCP did not have sufficient staff to carry out its oversight responsibilities. For example, OCRCP does not have enough

Electronic pull tab machines are games of chance played by the random selection of one or more pull tabs on a screen with winning determined by the predetermined appearance of concealed letters, numbers, or symbols. These devices are in a stand-alone cabinet and may resemble a traditional slot machine.

Social quarters are areas at charitable organizations' primary locations that are used by members for social activities, are not accessible to non-members, and are not advertised to the general public.

A September 2021 **Office of the State Inspector General (OSIG) review** found several problems with the Charitable Gaming Board's charitable gaming regulation and governance. Legislation was passed in the 2022 General Assembly Session to change charitable gaming regulation, including removing policy-making authority from the Charitable Gaming Board and charging VDACS staff with promulgating charitable gaming regulations.

OCRP has 21 authorized positions: two management (manager and gaming coach), seven inspection, seven audit, and five Texas Hold 'Em compliance positions.

OCRP has been holding the five Texas Hold 'Em positions vacant until that type of gaming begins.

Most types of gaming require regulators to conduct some type of **on-site, in-person compliance monitoring.**

For casinos, most states and the Virginia Lottery have several staff that conduct on-site compliance activities 24 hours a day, seven days per week.

For other types of gaming with less risk, regulators typically conduct periodic on-site inspections to ensure gaming operators comply with the law. The regulator typically determines the frequency of inspections for each gaming operator based on the risk associated with each operation.

VDACS has determined that three to four inspections, on average, is appropriate for Virginia charities, with larger gaming operations having more inspections and smaller gaming operations having fewer inspections.

staff to conduct a sufficient number of audits or inspections of organizations that sponsor charitable gaming. OCRP's goals are to audit each charity once every three years and inspect every charity three or four times per year. In 2020, the most recent year in which charitable gaming activities and OCRP inspections were not disrupted by the COVID-19 pandemic, OCRP did not meet its audit or inspection goals. In fact, in 2019 OCRP conducted fewer audits and inspections per charity and per dollar of wagering than it did in 2015, even though the number of charities decreased during that time period (Table 4-1). OCRP staff attribute their inability to meet audit and inspection goals to staff vacancies and difficulties filling positions.

TABLE 4-1

Annual audits and inspections per charity have decreased since 2015

	OCRP goal	2015	2020
Inspections per charity per year	3 to 4	2	1 to 2
Audits per charity	1 every 3 years	1 every 4 years	1 every 6 years
Audits to gross receipts ratio	-	1:\$3.23M	1:\$4.5M
Number of charities	-	359	294

SOURCE: JLARC analysis of OCRP data.

NOTE: 2019 is the most recent year of data before the pandemic interrupted the conduct and inspections of charitable gaming.

Further, inspection procedures require inspectors to ensure that games, including electronic pull tabs, are run properly, as well as require inspectors to ensure charities are following responsible gaming requirements, preventing the public from entering private social quarters, operating gaming only during permitted hours, and following other rules related to the charitable gaming environment.

Maintaining the frequency of OCRP's inspections and audits is important to ensure that gaming deficiencies are corrected, charities receive maximum benefits from charitable gaming, and criminal activity is deterred. OCRP's inspections and audits frequently find deficiencies in charitable gaming operations. For example, in 2020, inspectors conducted 420 on-site inspections, and OCRP issued 45 caution letters and 58 violation notices to charities describing found deficiencies in gaming. In addition, OCRP referred one case to law enforcement for criminal investigation. In 2021, even fewer inspections were conducted (because of the pandemic), 108, but OCRP still issued 46 caution letters and 58 violation notices and referred four cases to law enforcement for criminal investigation.

OCRP's audits typically discover over \$1 million of unreported gaming revenue annually and hundreds of thousands of dollars in inappropriate spending from gaming accounts. In years where OCRP conducted more audits than usual (90 audits in 2018 and 96 audits in 2017), staff discovered more unreported revenue (\$2.3 million in 2018 and \$3 million in 2019).

Maintaining inspection frequency also ensures that OCRP can provide technical assistance to charities. Charities are run by volunteers who may not know the best practices to ensure games run appropriately and are successful for the charity. OCRP inspectors develop a collaborative relationship with charitable organizations, and they provide technical assistance that not only ensures that games operate within the confines of the law but helps them to successfully generate funds for the charities.

OCRP will need at least 26 employees, compared with its current 11 employees, to adequately regulate traditional charitable gaming, and to regulate electronic pull tabs in social quarters and Texas Hold ‘Em poker tournaments which are its new regulatory responsibilities (Table 4-2). Ten existing positions need to be filled and five new positions need to be created. .

- To process the volume of licenses and permits required, OCRP needs to add two new positions for licensing. Currently, OCRP does not have dedicated licensing employees. Instead, it uses charitable gaming inspectors and other OCRP employees to issue charitable gaming permits and licenses. As OCRP begins licensing for social quarters and Texas Hold ‘Em poker tournaments, its licensing workload should increase, putting additional strain on existing employees. Assuming OCRP will process around 500 licenses and permits for organizations, manufacturers, bingo managers, and bingo callers annually, and one employee can process about 213 licenses a year, OCRP needs two employees for licensing.
- To ensure that charitable organizations and social quarters are inspected on a regular basis, OCRP needs to fill two inspector positions and add one new inspector position. This will result in OCRP having seven inspectors and one supervisor, eight total positions in inspections. (OCRP currently employs four inspectors and a supervisor.) According to OCRP staff, each inspector could perform five inspections per week. Assuming there are 48 working weeks in a year, each OCRP inspector could conduct 240 inspections per year. If each charitable organization and each social quarters is inspected three or four times per year, OCRP should conduct 1,778 inspections per year.
- To perform the number of audits required, OCRP will need to fill two auditor positions and add one new auditor position. This will result in OCRP having seven auditors and a supervisor. (OCRP currently employs four auditors and a supervisor.) OCRP needs to double the number of charitable organization audits it is currently performing (to move from auditing once every six years, around 50 per year, to once every three years, around 98 per year). Additionally, OCRP will have to conduct additional audits for social quarters, of which there are currently 214. That means that OCRP would need to perform approximately 168 audits annually to meet its goal with each audit taking nine to ten days to complete.

Other states with charitable gaming environments similar to Virginia include Kentucky and Minnesota. Charities in these states are permitted to host electronic pull tab terminals. Kentucky employs 28 staff to regulate charitable gaming, and Minnesota employs 39 staff to regulate charitable gaming.

- To ensure that electronic pull tab terminals comply with the state’s technical requirements and to provide technical assistance to inspectors reviewing electronic pull tab terminals operating in social quarters, OCRP should add one position that ensures technical compliance of gaming equipment. OCRP currently does not have any dedicated technology employees, however the current inspection staff are trained on electronic pull tab technology and are able to verify internal software and hardware compliance.

TABLE 4-2
Five additional positions needed to appropriately staff charitable gaming

Functional area	FTE positions^a	Workload	Workload measure	Additional positions needed
Licensing	0	500 licenses per year	213 licenses per year per employee	2
Enforcement (inspections)	7	1,778 inspections per year	240 inspections per year per employee	1 ^b
Texas Hold ‘Em compliance	5	n.a.	n.a.	0
Audit	7	169 audits per year	25 audits per year per employee	1 ^c
Technology	0	n.a.	n.a.	1
Management ^d	2	n.a.	n.a.	0
Total FTEs	21			5

SOURCE: JLARC staff analysis of staffing and workload data from VDACS.

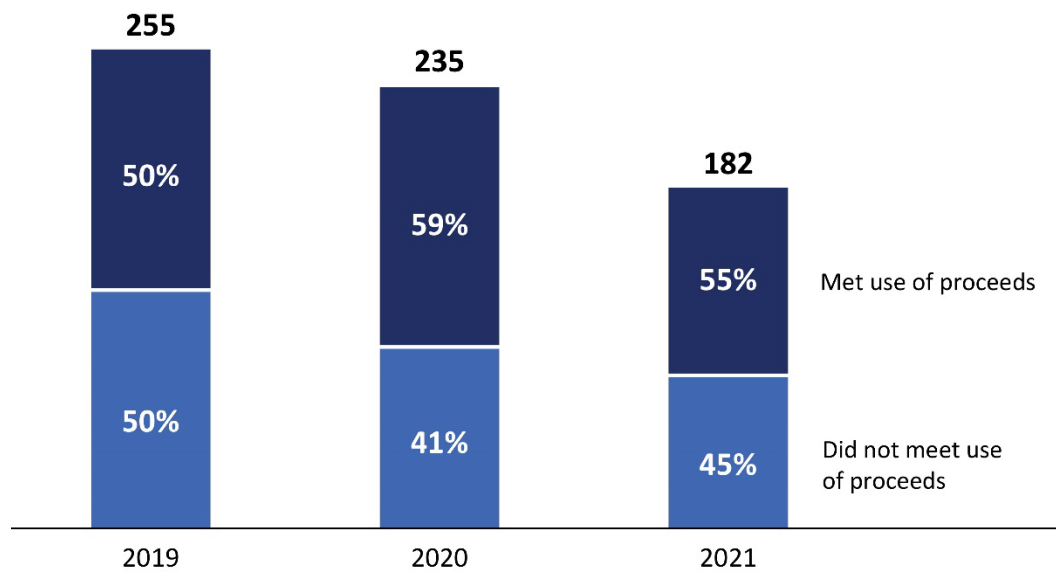
NOTE: ^a Of VRC’s 21 positions, 11 positions are currently filled (four inspectors and a supervisor, four auditors and a supervisor, and one manager). ^b Includes seven inspectors to handle the inspections workload, plus one supervisor for inspections. ^c Includes seven auditors to handle the audits workload, plus one supervisor for audits. ^d VDACS currently has two authorized positions that have been classified as management, one is the program manager for OCRP, and the other is a gaming coach. The gaming coach position is vacant.

Half of charities do not meet requirement that 10 percent of gaming proceeds go to charitable causes, and board has not enforced policy

State law permits charitable organizations to sponsor gaming events exclusively to raise funds for charitable purposes. To ensure that charitable organizations use their gaming proceeds for charitable purposes, Virginia regulations require organizations to spend 10 percent of the gross revenues generated from charitable gaming on “charitable purposes for which the organization was chartered.” Over the last three years, about half of charities have spent less than the required 10 percent of their charitable gaming revenues on charitable purposes (Figure 4-1).

FIGURE 4-1

Nearly half of charities dedicate less than 10 percent of gaming receipts to charitable purposes



SOURCE: JLARC analysis of OCRP data.

NOTE: Excludes charities that had no gaming revenue.

Organizations are not able to meet the 10 percent use of proceeds requirement when they spend more than 90 percent of their gross gaming revenue on the costs to operate charitable gaming events. These costs include gaming supplies and prizes. As new forms of gaming have been permitted in Virginia, organizations are reportedly having to spend more to attract players to charitable gaming events, such as by increasing prize limits. If these expenses are not offset by an increase in gaming revenue, charities may not have sufficient profits to meet the 10 percent use of proceeds requirement.

Although the use of proceeds requirement is intended to ensure that wagering on charitable gaming fulfills a public benefit, the Charitable Gaming Board has not enforced the policy. Previously, state law gave the board the ability to suspend or revoke organizations' charitable gaming permits if they did not meet the use of proceeds requirement, but legislation passed in 2022 gave that authority to the commissioner of VDACS. The board did not take either of these actions against any charity, despite the number of charities that do not meet the requirement. These regulations also gave the board the power to grant exceptions to charities that did not meet the requirement, which VDACS staff report the board did on multiple occasions. VDACS staff, instead of the board, now have the authority to impose sanctions on organizations that do not meet the use of proceeds requirement, and staff report that they are planning to actively enforce this requirement going forward (sidebar). However, given OCRP's staffing shortages, effectively enforcing this requirement, or even assisting charities with meeting the requirement, could be a significant challenge for OCRP.

Chapter 609 and 554 of the Acts of Assembly of 2022 amend statute to provide VDACS with the authority to act on permits without the approval of the Charitable Gaming Board. VDACS staff are planning to take enforcement action against 18 charities that have not met their use of proceeds requirements for four years.

The board's existing regulations remain in effect and are administered by VDACS until the VDACS commissioner promulgates new regulations consistent with the legislative changes.

Regulatory responsibility for charitable gaming should be transferred to Lottery

New York, Indiana, Michigan, Massachusetts, and Texas, regulate charitable gaming through larger gaming agencies.

Regulatory responsibilities for charitable gaming are growing, and these responsibilities should be transferred to Lottery because gaming regulation aligns better with Lottery's mission, and Lottery staff have superior expertise in gaming regulation. VDACS was recently made responsible for regulating electronic pull tab terminals in over 200 charitable organization social quarters, and in 2023 it will begin to regulate Texas Hold 'Em poker tournaments conducted by charitable organizations. Regulating charitable gaming is not a primary function for VDACS, which is chiefly responsible for promoting the economic growth and development of Virginia agriculture, providing consumer protection, and encouraging environmental stewardship. In contrast, gaming regulation has become core to Lottery's mission. Additionally, Virginia Lottery's expertise and experience regulating slot machines is valuable for the regulation of charitable organizations' electronic pull tab terminals. Lottery staff also have experience regulating table games and casinos, which would be valuable for implementing Texas Hold 'Em poker tournament regulations.

Virginia Lottery may also be better able than VDACS to recruit and retain employees for regulating charitable gaming. As an independent state government agency, Lottery has more flexibility and can generally pay the higher salaries that appear to be needed to recruit and retain staff to regulate charitable gaming. Lottery currently pays higher salaries than VDACS for similar positions. For example, Lottery's average auditor salary is \$23,000 higher than a charitable gaming auditor at VDACS. Charitable gaming auditor positions are some of the most challenging for VDACS to fill.

VDACS pays auditors an average salary of \$61,700. The average salary for auditors across state agencies is \$68,927 (12 percent higher than VDACS auditors).

Lottery would require additional staffing and resources to regulate charitable gaming

Lottery would need at least 26 positions to regulate charitable gaming, 21 of which could be transferred from VDACS. Only 11 of the existing 21 charitable gaming positions are currently filled. Five additional positions for licensing (2), inspection (1), audit (1), and technology (1) would need to be created to adequately regulate charitable gaming. These five additional positions would need to be filled whether charitable gaming regulation is transferred to Lottery or VDACS continues to be the regulator.

Fully staffing charitable gaming regulation at Lottery will cost approximately \$400,000 more than if VDACS were fully staffed because of Lottery's higher salaries (Table 4-3). Salaries for audit and licensing staff are over 20 percent higher than VDACS's salaries for similar positions. However, these higher salaries will likely help Lottery to recruit and retain employees for charitable gaming regulation.

TABLE 4-3

Fully staffing the regulation of charitable gaming requires additional funding at either VDACS or Lottery

Function area	FTEs needed	Cost at VDACS	Cost at Lottery
Personnel costs (salaries plus fringes)			
Licensing	2	\$196K	\$233K
Enforcement (inspections)	8	771	791
Texas Hold 'Em compliance	5	482	495
Audit	8	848	1,097
Technology	1	135	147
Management	2	245	265
Overhead			
Non-personnel costs		374	425
Total costs	26	\$3,051K	\$3,453K

SOURCE: JLARC staff analysis of staffing and workload data from VDACS and staffing data from the Virginia Lottery.

NOTE: Figures are rounded to the nearest 1,000. Assumes Lottery would adjust salaries to be comparable to Lottery employees performing similar functions.

Though they would need more staff, Lottery should maintain OCRP's existing policies and procedures related to charitable gaming. OCRP does not conduct enough audits and inspections, but the audits and inspections it does conduct appear to be thorough and effective. Further, OCRP's inspection procedures are detailed and require investigators to address key risks associated with charitable gaming.

RECOMMENDATION 12

The General Assembly may wish to consider amending §18.2-340.15 of the Code of Virginia to move authority for regulating charitable gaming from the Virginia Department of Agriculture and Consumer Services to the Virginia Lottery.

Charitable gaming fees have covered regulatory costs but will not be sufficient to fund additional staff

VDACS charges fees to charities that are intended to cover the cost of regulation. These fees range from \$75 for registering as a bingo caller or manager to \$1,000 for licensing a gaming supplier. VDACS also charges charities an audit and administration fee, which was lowered from 1.375 to 0.75 percent in the 2022 General Assembly Session. The audit and administration fee is applied against gross gaming revenues for traditional charitable gaming, and beginning in FY23, it will be applied against adjusted gross gaming revenues (gross revenues minus prizes paid to players) for electronic pull tabs. In 2020, the most recent year not impacted by the pandemic for which data was available, VDACS collected almost \$2.4 million in fees (sidebar).

The current audit and administration fee (0.75 percent) will not generate enough funds to offset the cost of sufficiently regulating charitable gaming. Fully staffing existing positions and adding the five positions needed to sufficiently inspect charitable gaming

Chapter 722 and 767 of the Acts of Assembly of 2022 amended the Code of Virginia §18.2-340.31 to restrict electronic pull tabs to social quarters, and provide VDACS with jurisdiction for electronic pull tabs. This legislation also **adjusted the audit and administration fee** to account for additional revenues from electronic pull tabs.

The legislation initially capped the audit and administration fee at 1.5 percent, but a governor's amendment changed the maximum rate to 0.75 percent. The 0.75 percent rate was intended to generate the same revenue when applied to traditional charitable gaming and electronic pull tabs as was generated in 2021 through traditional charitable gaming only, approximately \$1.7 million.

The audit and administration fee was 1.375 percent in 2020 when \$2.4 million in fees were collected.

operations and provide adequate assistance to charities will cost approximately \$2.9 million at Lottery or \$2.5 million at VDACS. For charitable gaming regulation to be fully self-supporting, the audit and administration fee would need to be set at 1.4 percent to generate \$2.9 million, or 1.2 percent to generate \$2.5 million.

Once Texas Hold ‘Em poker tournament regulations are finalized and play begins, the charitable gaming regulator should determine whether the increased audit and administration fee covers the cost of regulating those activities, which will range from approximately \$549,000 at VDACS to \$563,000 at Lottery. If the increased audit and administration fee does not generate enough funds from Texas Hold ‘Em poker tournaments to support the regulatory program, the regulator should seek legislative authorization to further increase the audit and administrative fee to cover the cost of regulating Texas Hold ‘Em poker tournaments.

Charitable Gaming Board should be maintained, and one member should be added to Lottery’s board

Chapter 554 and 609 of the Acts of Assembly of 2022 amended the Code of Virginia §2.2-2455 to change the Charitable Gaming Board from a policy board to an advisory board and to change its membership from 11 to nine members.

A 2021 Office of the State Inspector General (OSIG) report found the previous board structure allowed for inherent conflicts of interest.

If charitable gaming regulation is transferred to Lottery, the Charitable Gaming Board should be maintained, and but should become an advisory board to the Lottery Board. Additionally, the membership of the Lottery Board should be modified to add one position to the board and require that it be filled by a member of the charitable gaming advisory board who would serve as an ex-officio voting member. To satisfy the ethical requirements for Lottery board members, the new position would need to be filled by a member of the six Charitable Gaming Board members who do not have an interest in charitable gaming.

RECOMMENDATION 13

If the Virginia Lottery Board is given responsibility to regulate charitable gaming, the General Assembly may wish to consider amending §2.2-2455 and §2.2-2456 of the Code of Virginia to establish the Charitable Gaming Board as an advisory board to the Virginia Lottery with responsibility for advising the Lottery on the conduct of charitable gaming.

RECOMMENDATION 14

If the Virginia Lottery Board is given responsibility to regulate charitable gaming, the General Assembly may wish to consider amending §58.1-4004 of the Code of Virginia to direct that a position be established on the Lottery Board to be filled by a member of the Charitable Gaming Board who would serve as a voting ex officio member.

Charitable gaming regulator should maintain a collaborative approach to regulating charities

Commercial gaming, which carries more risks, should be more stringently regulated than charitable gaming. The volume of cash wagered through charitable gaming is lower than through casinos, and charitable gaming operators are prohibited from personally benefiting from gaming activities. Charities and their gaming operations are run by part-time volunteers who require technical assistance and support to operate profitable gaming operations and comply with charitable gaming regulations. The relationship between OCRP and the charities it regulates has historically been collaborative, and OCRP has provided assistance and support to charities to the extent its resources have allowed. If charitable gaming regulation is transferred to Lottery, this collaborative approach to regulation should be maintained. In particular, the charitable gaming regulatory requirements used by Lottery could avoid penalizing organizations for unintentional violations. Additionally, the Lottery could hire one or more staff to serve as gaming coaches to provide technical assistance to charities.

5 Unregulated Electronic Gaming Machines

Virginia has been grappling with the proliferation of unregulated electronic gaming machines, or “gray machines,” for the past several years. Gray machines can be found in bars, convenience stores, and restaurants across the state. The term gray machine refers to the notion that these machines operate in a gray area of the law—gray machines were neither permitted nor prohibited in Virginia law until 2020 when they were temporarily legalized for one year.

Gray machines are electronic gaming terminals that look similar to a slot machine from a player’s perspective (Figure 5-1). The gray machine experience typically begins with a slot-machine style game. After the initial spin, according to manufacturers, players on gray machines can adjust the symbols to create a winning pattern. According to manufacturers, players can complete a memory-style game after losing a game to try to win back their original bet. Manufacturers contend that because players can have some impact on the outcome of a game through their decision making, their games are skill based rather than chance based and therefore should not be considered gambling.

Unregulated electronic gaming machines are referred to as **gray machines** in this report, and are commonly referred to as **games of skill** by the media and device manufacturers.

The Code of Virginia §18.2-325 refers to the machines as “**skill games**.”

FIGURE 5-1
Gray machines in Virginia convenience stores



SOURCE: JLARC staff.

Legislation passed in the 2020 General Assembly session defined skill games and characterized them as illegal gambling, but the legislation’s enactment was delayed for one year. The governor and General Assembly amended the legislation to permit the operation of gray machines from July 1, 2020 to June 30, 2021, tax gray machine distributors \$1,200 per machine per month, and direct Virginia Alcohol Beverage Control Authority (ABC) to regulate and facilitate tax collection on the gray machines. On July 1, 2021, the state law prohibiting gray machines went into effect.

Gray machines continue to operate unregulated in Virginia as of October 2022. Although the prohibition on gray machines became effective on July 1, 2021, a company

that hosts gray machines at several truck stops filed a lawsuit challenging the prohibition. In December 2021, a circuit court judge issued a temporary injunction on the ban. As a result, many gray machines are still operating. The court is expected to hear the case and issue a ruling on the lawsuit in November 2022.

Unregulated gray machines create risks for Virginians, businesses, and other regulated gaming

While it is unclear whether the state can ban gray machines, leaving the machines unregulated clearly creates risks for players and businesses. Gray machines currently pose a risk for fraudulent activities because there are no state regulations, audits, or compliance activities for the devices, manufacturers, or vendors. Without any compliance inspections, such as those conducted for slot machines, historical horse racing (HHR) machines, and electronic pull tab machines, the amount of money played and awarded to players cannot be determined. As a result, businesses that receive a proportion of machine revenue have no way of knowing whether they are receiving the correct amount of money from the machine manufacturers. Further, consumers who play the machines have no assurances that the games are fair (sidebar).

Gray machines also create public safety risks. Commonwealth's attorneys from multiple localities reported that crimes such as assault and robbery have increased at establishments with gray machines. They attribute this rise in crime to several factors, including that the machines generate loitering, the use of cash attracts crime, and businesses that host the machines typically do not have the appropriate resources to secure the gaming environment.

Georgia, one of the only states that regulates gray machines, has eliminated cash prizes to reduce crime associated with gray machines. Instead of cash prizes, players in Georgia can win non-cash business merchandise (excluding alcohol, tobacco, and gift cards to other businesses) or lottery tickets. All prizes must be redeemed at the business where the machine is located, thereby reducing incentives for theft.

Without any restrictions, number of gray machines will likely continue growing

Without oversight or regulation of gray machines, it is impossible to know exactly how many gray machines operate in Virginia, but ABC identified about 9,000 gray machines when the agency regulated them in FY21. Based on reports that the number of machines has increased since ABC stopped regulating them, there are likely now more than 9,000 machines statewide (sidebar).

Virginia's population could support up to 20,000 terminals (Table 5-1). Gray machine manufacturers identified by ABC reported that in FY21, consumers wagered over \$2 billion on gray machines. However, this figure likely undercounts total wagering, since

Even if gray machines function properly, data collected by ABC in FY21 shows that gray machines have much lower average payout rates than other electronic gaming devices. In Virginia, slot machines, HHR machines, and electronic pull tab machines all have average payout rates of roughly 90 percent meaning that, on average, gamblers make back 90 percent of the money they gamble on them. Gray machines appear to have an average payout rate of roughly 77 percent, meaning players make back less money on gray machines compared with those used in regulated gaming.

Virginia gaming regulators typically set requirements on payout percentages from electronic gaming machines.

Virginia Lottery regulations require that slot machines have an average payout percentage between 84 and 100 percent over time.

Charitable gaming regulations require electronic pull tab manufacturers to disclose the payout percentage on machines.

ABC was not able to verify the revenue information reported by the machines' manufacturers.

TABLE 5-1
Virginia's gray machine market may still be growing

	Georgia (2020)	Virginia (2020)	Virginia (growing)	Virginia (maximum)
Grey machine landscape				
State population	10,800,000	8,600,000	8,600,000	8,600,000
Number of gray machines	24,500	9,000	14,300	19,600
People per gray machine	441	956	601	439
Total wagering on gray machines	\$3B	\$2.2B	\$3.5B	\$4.8B
Net revenue per machine per day	\$101	\$152	\$152	\$152

SOURCE: JLARC staff analysis of staffing data from the Georgia Lottery and gray machine data self-reported to ABC in 2020.

NOTE: Georgia has a more limited gaming environment than Virginia (no sports wagering, horse race wagering, casinos, or HHR machines), which may allow gray machine operators to operate more machines per capita than could be profitably operated in Virginia, where more gaming options exist.

“While the regulations were in place through ABC, new gaming establishments and machines didn't pop up. Right now though, it's just an absolute free-for-all.”

– Commonwealth's attorney

Gray machines likely compete with legal gaming and therefore reduce state tax revenue from authorized gaming—and also funding for the public purposes legal forms of gaming support. Virginia limits the number of casinos and HHR machines in the state and the number of electronic pull tab devices that can be located in a single charitable establishment (sidebar). Without similar restrictions, competition from gray machines will likely increase—and gray machines already outnumber HHR machines, electronic pull tabs, and slot machines in Virginia. Since unregulated gray machines generate no tax revenue for the state, competition from gray machines is likely depressing state tax revenue from legal gaming. Funding for public purposes supported by legal gaming, such as live horse racing, charitable organizations, or revitalization of local economies, is also likely depressed.

Georgia has limited the number of skill games allowed in any single location. Georgia prevents businesses from hosting more than nine gray machines at a single location or deriving more than 50 percent of their monthly gross retail receipts from gray machines. This prevents businesses from using gray machines to operate a business that's primary function is gambling. In Virginia, similar restrictions would limit the competition with other forms of legal gambling.

Annual tax revenues could range from \$129 million to \$282 million

Gray machines could generate tax revenue for Virginia. If gray machines were permitted and taxed at the same rate as in FY21, and the number of machines remained at around 9,000, annual tax revenues would be around \$129.8 million (Table 5-2). If the

Virginia imposes limits on the proliferation of legal forms of gaming. For example, the Commonwealth limits the total number of historical horse racing machines in the state to 5,000. The state limits the number of electronic pull tab terminals in any social quarters to nine. The state limits the total number of casinos allowed in the state to five, and it limits where those casinos may be located. The state has also limited the number of online sports wagering platforms operating in the state to 19.

number of machines grew to the same number operating in Georgia, annual tax revenues would be \$282.2 million. However, gray machines compete directly with other kinds of legal gambling in Virginia, and gains in revenue from gray games may diminish tax revenue generated from other forms of gaming.

TABLE 5-2
Gray machines could generate tax revenue for Virginia

	Virginia (2020)	Virginia (growing)	Virginia (maximum)
Number of gray machines	9,000	14,300	19,600
Total wagering on gray machines	\$2,246.5M	\$3,527.6M	\$4,835.1M
Net gaming revenues	\$506.7M	\$794.9M	\$1,089.6M
Tax rate (per machine per month)	\$1,200	\$1,200	\$1,200
Effective tax rate on net gaming revenue	26%	26%	26%
Annual tax revenue	\$129.8M	\$205.9M	\$282.2M

SOURCE: JLARC staff analysis of gray machine data self-reported to ABC in 2020.

NOTE: This does not account for any potential negative impact on revenue from other forms of gaming.

If lawmakers opted to regulate and tax gray machines, taxing the machines based on their net gaming revenue ensures tax payments increase in proportion to the operators' profits. If Virginia Lottery were to regulate the machines and use a central monitoring system, as Georgia does for the machines operating there, Lottery could ensure the state is receiving all tax payments to which it is entitled. When ABC regulated the gray machines in FY21 on a temporary basis, it could not confirm gray machines' gross or net gaming revenue, which made implementing a tax based on a percent of net gaming revenues impractical. Lottery could use a central monitoring system to enable a percent tax rate. The per machine tax rate that Virginia used in FY21 was equivalent to a 26 percent tax on net gaming revenues.

Virginia Lottery could regulate gray machines for between \$9 million and \$20 million annually

Georgia regulates gray machines through its state lottery. In 2020, the Georgia Lottery spent approximately \$18 million to regulate over 24,500 gray machines at over 4,700 locations across the state. The Georgia Lottery employs 47 full-time employees to work on licensing, compliance inspections, audits, and technology compliance. The Georgia Bureau of Investigations also employs at least two investigators as part of its Commercial Gambling Unit, which is responsible for enforcing Georgia's gambling laws related to gray machines.

If legislators opt to permit and regulate gray machines, setting up a regulatory structure similar to Georgia's would cost almost \$9 million annually, assuming the current number of operating terminals (9,000) (Table 5-3). With fewer machines than Georgia's 24,500, Virginia would need fewer employees and resources dedicated to gray machine

regulation. If Virginia's gray machine market continues to grow, regulating gray machines could cost up to \$20 million annually.

TABLE 5-3

Cost of regulating gray machines could grow to \$20 million depending on the number of gray machines in the state

Functional area	Existing gray games		Maximum market for gray games	
	FTEs	Cost	FTEs	Cost
Personnel costs (salaries plus fringe benefits)				
Licensing	6	\$650K	12	\$1,300K
Enforcement	5	545	11	1,200
Audit	4	452	10	1,130
Technology	2	241	4	482
Other (executive, legal)	2	509	6	1,527
Overhead costs				
Non-personnel costs	-	336		789
Central monitoring system	-	6,248		13,607
Total costs	19	\$8,981K	43	\$20,035K

SOURCE: JLARC staff analysis of staffing data from the Georgia Lottery, the Virginia Lottery, and the Virginia Alcoholic Beverage Control Authority.

Connecting gray machines to a central monitoring and audit system would be essential for effective regulation. ABC staff who regulated gray machines in FY21 noted that without a central monitoring system, they were unable to verify how much money gray machines collected and awarded in prizes. Instead, they relied on self-reported figures from gray machine manufacturers, which they suspected were not always reliable. Georgia's experience regulating gray machines demonstrates the importance of being able to independently verify financial information from machine manufacturers; when Georgia connected the machines to a monitoring system in 2015, they found that the machine-reported revenue was nearly double that which was self-reported by machine manufacturers.

Like all forms of legal gambling, gray machines would continue to carry risks even if they were regulated. Because the machines resemble slot machines and are highly accessible, they pose a relatively large risk for problem gambling. In addition, because the businesses hosting gray machines are not as secure as casinos or HHR facilities, the risk for underage gaming would remain a concern.

If the state permits and regulates gray machines in the future, the Virginia Lottery should be assigned responsibility for regulating the machines. Virginia Lottery has expertise in gaming and regulating electronic machines and as an independent agency has the flexibility to quickly establish a gray machines regulatory framework and compliance operation. However, Lottery would need additional staff to set up and operate gray machine regulation. Lottery's existing staff are fully utilized in lottery sales and

existing commercial gaming compliance operations. Additionally, gray machine regulation should be maintained separately within Lottery so it can be budgeted and paid for separately through gray machine tax revenues.

Appendix A: Study resolution

Oversight and Administration of Gaming in the Commonwealth

Authorized by the Commission on January 10, 2022

WHEREAS, the forms of legal gaming in Virginia have expanded in recent years and include lottery, charitable gaming, pari-mutuel wagering on horse racing, casino gaming, online gaming, and sports betting; and

WHEREAS, these forms of gaming are administered and overseen by three different executive branch agencies: the Virginia Lottery, the Virginia Department of Agriculture and Consumer Services, and the Horse Racing Commission; and

WHEREAS, all forms of gaming require some similar administrative and oversight activities, such as licensing of gaming entities and inspections of facilities, equipment, and finances; and

WHEREAS, any form of gaming has the potential to be a source of illegal or unethical activities, such as fraud and self-dealing and therefore requires effective regulation and enforcement; and

WHEREAS, there may be opportunities to reduce duplication of administrative functions across the three agencies and better leverage each agency's resources to improve oversight and enforcement of gaming activities to deter illegal or unethical activities and hold gaming entities responsible for such activities; and

WHEREAS, several states combine oversight of multiple types of gaming into a single agency; and

WHEREAS, a 2019 report of the Joint Legislative Audit and Review Commission (JLARC) proposed the option of evaluating the roles, responsibilities, and performance of all Virginia gaming oversight agencies after additional forms of gaming have been implemented to determine whether consolidation of gaming oversight responsibilities is warranted; now, therefore be it

RESOLVED by the Joint Legislative Audit and Review Commission that staff be directed to assess the advantages and disadvantages of consolidating the administration and oversight of Virginia's gaming activities into a single executive branch agency. In conducting the study, staff shall (i) evaluate the roles and responsibilities of each agency and the staffing and financial resources dedicated to them; (ii) identify potentially duplicative roles and responsibilities that could more efficiently and effectively be carried out under one agency; (iii) evaluate the effectiveness of each agency's enforcement policies and activities; (iv) compare and contrast the regulatory requirements used by each agency to carry out its roles and responsibilities, including licensing and inspection requirements; (v) consider how, if at all, consolidation could affect the various missions of the agencies that regulate gaming; and (vi) examine other states' approaches to administering and supervising legal gaming.

JLARC shall make recommendations as necessary and review other issues as warranted.

All agencies of the Commonwealth, including the Virginia Lottery, Horse Racing Commission, Virginia Department of Agriculture and Consumer Services, the Virginia State Police, and the Office of the Attorney General shall provide assistance, information, and data to JLARC for this study, upon request. JLARC staff shall have access to all information in the possession of agencies pursuant to §30-59 and § 30-69 of the Code of Virginia. No provision of the Code of Virginia shall be interpreted as limiting or restricting the access of JLARC staff to information pursuant to its statutory authority

Appendix B: Research activities and methods

Key research activities performed by JLARC staff for this study included

- Interviews with leadership and staff of state agencies and gaming experts,
- Attendance at relevant board and stakeholder meetings,
- Review of research literature and other documents,
- Review of state laws, regulations, and policies relevant to gaming, and
- Data collection and analysis from the Office of Charitable and Regulatory Programs at the Virginia Department of Agriculture and Consumer Services, the Virginia Lottery, and the Virginia Racing Commission.

Structured interviews

Structured interviews were a key research method for this report. JLARC staff conducted approximately 40 interviews for this study. Key interviews included:

- Virginia Lottery staff,
- Office of Charitable and Regulatory Programs staff,
- Virginia Racing commission staff,
- Other Virginia state agency staff, and
- Other stakeholders.

Virginia Lottery staff

JLARC staff conducted eight interviews with Virginia Lottery staff. Topics varied across interviews but were primarily designed to understand how Lottery licenses lottery retailers, casino operators, and sports betting operators, how Lottery enforces laws, rules, and regulations related to the lottery, casinos, and sports betting, how Lottery operates the Virginia lottery, and Lottery's responsible gaming policies.

Office of Charitable and Regulatory Programs staff

JLARC staff conducted six interviews with OCRP staff regarding the regulation of charitable gaming. Interview topics included recent legislative changes related to charitable gaming, procedures for licensing, auditing, and inspecting charitable organizations, and laws, rules, and regulations related to charitable gaming. In addition to structured interviews, JLARC staff also had follow-up conversations with OCRP staff to clarify issues, better understand data sources, and ask follow-up questions.

Virginia Racing Commission Staff

JLARC staff conducted three interviews with VRC staff regarding the regulation of horse race wagering in Virginia. Interview topics included the introduction of historical horse racing, licensing for live and historical horse racing, and enforcing laws, rules, and regulations related to horse race wagering. In addition to structured interviews, JLARC staff also had follow-up conversations with VRC staff to clarify issues, better understand data sources, and ask follow-up questions.

Other Virginia state agency staff

JLARC staff conducted structured interviews with other state agency staff that have or have had a role in gambling regulation or have experience with agency consolidations. JLARC staff interviewed staff at the following agencies:

- Alcoholic Beverage Control,
- Department of Accounts,
- Department of Behavioral Health and Developmental Services,
- Department of Education,
- Department of Human Resource Management,
- Department of Planning and Budget,
- Office of the Secretary of Agriculture and Forestry,
- Office of the State Inspector General, and
- Virginia State Police.

Interview topics varied across interviews but were primarily designed to understand perceptions and concerns around unregulated and illegal gambling; regulation of gray machines during FY21; planning, coordination, and implementation of problem gaming prevention and treatment programs; perceptions of the effectiveness and adequacy of regulation of charitable gaming, horse race wagering, and commercial gaming in Virginia; and, logistics of previously completed state agency consolidations and mergers (such as the movement of functions from the Department of Social Services to the Department of Education, and the merger that created the Department of Small Business and Supplier Diversity).

Other stakeholders

JLARC staff conducted interviews with a variety of other stakeholders with interests in gaming policy in Virginia. These stakeholders included:

- Caesars Entertainment,
- Charitable Gaming Board (chair),
- Colonial Downs,
- Commonwealth's Attorneys,
- organizations that conduct charitable gaming,
- Regulatory Management Counselors,
- Virginia Equine Alliance, and
- Virginia Racing Commission (vice chair).

Interview topics varied across interviews but were primarily designed to understand perceptions of the effectiveness and adequacy of regulation of charitable gaming, horse race wagering, and commercial gaming in Virginia; regulatory models used by other states for horse race wagering, charitable gaming, and gray machines; prevalence of and specific concerns around illegal gambling; and, opinions about options for consolidating gaming regulation into fewer state agencies.

Attendance at relevant board and stakeholder meetings

JLARC staff attended various relevant board meetings throughout this study. Meetings included:

- April and July 2022 Virginia Lottery Board meetings, and
- April and June 2022 Virginia Racing Commission meetings.

Review of national research and experience of other states

Document review was a key method for this study. JLARC staff conducted a review of literature and documents related to various aspects of gaming in Virginia and nationwide, including:

- National literature on gambling, including articles published by the University of Nevada Las Vegas Gaming Press. JLARC staff also drew from the literature review conducted for JLARC's 2019 report, *Gaming in the Commonwealth*,
- Documents and reports related to the function and organization of gaming agencies in other states, such as organizational charts, budgets, and annual reports. Other states reviewed included Indiana, Kentucky, Maryland, Massachusetts, Michigan, Minnesota, New York, Ohio, West Virginia, and Georgia (gray machines only).

Review of state laws, regulations, and policies relevant to gaming

JLARC staff reviewed sections of the Code of Virginia and the Virginia Administrative Code related to:

- Virginia Racing Commission and horse race wagering,
- charitable gaming and fantasy contests,
- Virginia Lottery, (including pertaining to casino gaming and sports betting), and
- gray machines.

JLARC staff also reviewed documents and internal policies from Virginia's existing gaming agencies, including:

- license applications and procedures,
- internal guidelines for licensing investigations,
- audit and inspection procedures,
- notices of noncompliance to gaming operators, and
- organizational charts and position descriptions.

Data collection and analysis

JLARC staff collected and analyzed two types of data for this report: staffing and workload data from existing gaming agencies and gaming revenue and tax reports from existing gaming agencies. This data was used to help estimate staffing needs to effectively regulate gaming in Virginia and estimate how gaming revenue may grow in the coming years.

Staffing and workload analysis

JLARC staff used staffing ratios identified in JLARC's 2019 report, *Gaming in the Commonwealth*, along with information about existing gaming agencies' workloads to estimate how many staff would be needed to effectively regulate each of Virginia's forms of legal gaming. JLARC staff also used data from the Alcoholic Beverage Control and the Georgia Lottery to estimate how many staff would be needed to effectively regulate gray machines, should the General Assembly choose to regulate them.

To estimate the number of staff that would be needed to effectively regulate historical horse racing (HHR) wagering, JLARC staff relied on staffing data collected from the casino oversight agencies in Kansas, Maryland, Massachusetts, Michigan, and Ohio for the 2019 report. This data was used to determine staffing ratios because few states have widespread HHR wagering, and those states that do (Kentucky and New Hampshire) have different gaming environments from Virginia (no casinos) and have only had widespread HHR wagering for a limited amount of time. Additionally, according to VRC staff and Colonial Downs/Rosie's staff, HHR facilities operate in a very similar fashion to casinos with the exception that HHR facilities do not have table games.

Using this staffing data, JLARC staff determined staffing ratios for each of the major functional areas of the agency, including licensing, enforcement, audits, and technology. For licensing, the staffing ratio was determined based on the number of gaming facility employees per state oversight agency licensing employee. For enforcement and technology, the staffing ratios were based on the number of state oversight employees per gaming facility. For audits, the staffing ratio was determined based on the state's total gross gaming revenue per state oversight audit employee. JLARC staff then made adjustments to the staffing ratios for enforcement, technology, and audit because HHR facilities have a lower risk profile than a casino with no table games (some of the ways that this lowers risk is that HHR facilities have fewer employees with access to cash, there are fewer opportunities to cheat because games are automated, and all cash that is spent on gaming is inserted in a machine connected to monitoring and accounting systems) and HHR terminals being server-based as opposed to having on-board programming (reduces risk because all terminals can be controlled and monitored from one central server). Staffing ratios for enforcement were reduced by 90 percent and staffing ratios for audit and technology were reduced by 50 percent to account for the lower risk associated with HHR facilities. JLARC staff estimated that a total of 15 staff would be needed to effectively regulate HHR (Table B-1).

In order to calculate the number of employees OCRP would need in order to effectively regulate charitable gaming, JLARC staff first worked with OCRP staff to identify an appropriate workload for licensing employees, inspectors, and auditors. JLARC staff then used data from OCRP to determine how many licenses they process each year and how many audits and inspections they would need to conduct per year to meet their internal goals. Using that information, JLARC staff came up with the ratios displayed in Table B-2 and determined that OCRP needs two licensing employees, eight inspectors (seven inspectors plus a supervisor), and eight auditors (seven auditors plus a supervisor). Finally, since OCRP is now responsible for regulating the use of electronic pull tab machines at charities, JLARC staff determined that they would need to hire someone who specializes in gaming technology.

TABLE B-1
Fully staffing the regulation of HHR would require 15 employees

Functional area	Workload	Workload measure	FTEs needed
Licensing	1,100 per year	213 licenses per year per employee	5
Enforcement (inspections)	6 facilities	0.9 per facility	5
Audit	\$588 million gross revenue per year ^a	\$254 million in gross revenue per auditor	2
Technology	6 facilities	0.5 employees per facility	3
Total FTEs			15

SOURCE: JLARC staff analysis of staffing and workload data from VRC.

NOTE: ^a Gross revenue refers to the total amount wagered less the amount paid back to players.

TABLE B-2
Fully staffing the regulation of charitable gaming would require 26 employees

Functional area	FTEs filled	Workload	Workload measure	FTEs needed
Licensing ^a	0	500 licenses per year	213 licenses per year per employee	2
Enforcement (inspections) ^b	5	2,099 inspections per year	240 inspections per year per employee	8
Texas Hold' Em compliance ^c	0	-	-	5
Audit ^d	5	169 audits per year	25 audits per year per employee	8
Technology ^e	0	-	-	1
Management ^f	1	-	-	2
Total FTEs ^g	11			26

SOURCE: JLARC staff analysis of staffing and workload data from VDACS.

NOTE: ^a VDACS does not have any authorized positions for licensing. ^b VDACS has seven positions authorized for inspections, but only five are filled. ^c VDACS has five authorized positions for Texas Hold' Em compliance, but it has been holding those positions vacant until regulations are promulgated and this type of gaming begins. ^d VDACS has seven positions authorized for audits, but only five are filled. ^e VDACS does not have any positions authorized for technology compliance. ^f VDACS currently has two authorized positions that have been classified as management, one is the program manager for OCRP, and the other is a gaming coach. The gaming coach position is vacant. ^g VDACS is authorized for 21 positions for charitable gaming regulation but only 11 are filled.

Finally, JLARC used information collected by the Alcoholic Beverage Control during the year that they regulated skills games and data and staffing information from Georgia Lottery. The Georgia Lottery regulates gray machines, and JLARC staff used ratios of their staff to the number of machines and amount of wagering that exist in the state to estimate how many staff Virginia would need to effectively regulate gray machines (Table B-3).

TABLE B-3

Regulating gray machines could require between 19 and 43 employees depending on the number of machines

	Georgia (2020)	Virginia (2020)	Virginia (growing)	Virginia (mature)
Gray machine landscape				
State population	10,800,000	8,600,000	8,600,000	8,600,000
Number of skill machines	24,500	9,000	14,300	19,600
People per skill machine	441	956	601	439
Total wagering on skill machines	\$3B	\$2.2B	\$3.5B	\$4.8B
Win per machine per day	\$101	\$152	\$152	\$152
Regulatory employees needed				
Licensing	15	6	10	12
Enforcement	14	5	8	11
Audit ^a	8	4	7	10
Technology	5	2	3	4
Other (executive, legal)	5	2	4	6
Total employees needed	47	19	32	43
IT resources needed				
Central monitoring system (cost)	\$11M	\$6M	\$10M	\$14M

SOURCE: JLARC staff analysis of staffing data from the Georgia Lottery and the Virginia Lottery.

NOTE: ^a The number of auditors needed depends on the amount of revenue generated by skill machines. Virginia's skill machines generate more revenue per machine than Georgia's machines. As a result, Virginia would need more auditors than Georgia, even with slightly fewer machines.

The estimated costs for adequately regulating HHR facilities, charitable gaming, and gray machines includes personnel salary and fringe benefit costs, non-personnel overhead costs (office rent, supplies, travel, etc.), and the cost of a central monitoring system for gray machines. JLARC staff collected data on lottery's staffing structure and pay structure. JLARC staff used Department of Human Resources Management (DHRM)'s compensation and employment information data for Virginia Lottery employees in June 2022 to identify lottery employees in similar positions to licensing, enforcement, audit and technology positions with 10 or fewer years of state service. To calculate personnel costs, average lottery employee salaries were used. JLARC staff calculated the cost of fringe benefits (health insurance, retirement contributions, Medicare contributions, and Social Security contributions) by using rates published in the Department of Planning and Budget's 2022 Decision Package Instructions, and adding this to the salary estimates to arrive at the total estimated cost for personnel. Non-personnel costs were estimated to be approximately 14 percent of salary and fringe costs. Finally, the cost of a central monitoring system for gray machines was estimated using the rate that Georgia was paying its contractor for the central monitoring system in use there (1.2489 percent of net gaming revenues).

Gaming revenue projection analysis

Gaming revenue data was gathered from each of the gaming agencies going back to at least 2012. JLARC staff adjusted gaming revenues for inflation to 2021 dollars using Consumer Price Index for

All Urban Consumers from the Federal Reserve Bank of St. Louis' Federal Reserve Economic Data. Annual gaming revenue data was also rounded to the nearest thousand. To project gaming revenues for 2022 through 2025, JLARC staff assumed growth rates for each form of gaming based on the past several years of performance, as well as any policy changes that were made that could impact gaming revenue performance in the future.

For charitable gaming, a negative 2.3 percent annual growth rate was assumed for traditional charitable gaming receipts for 2022 through 2025. This negative growth rate was the average annual growth rate for traditional charitable gaming receipts for 2016 through 2021, excluding 2020 (2020's growth rate was excluded because it was -46 percent, likely as a result of the pandemic and an inability to host in-person bingo games during that year). For the electronic pull tab receipts, projected receipts for 2022 was assumed to be the same as 2021 receipts, but reduced by approximately \$220 million. This assumption was made because legislative changes made in the 2022 General Assembly Session are expected to result in fewer electronic pull tab machines being located in charities across the state, which should result in a decline in electronic pull tab receipts. The \$220 million reduction was determined based on data provided by OCRP. For 2023 through 2025, it was assumed that electronic pull tab receipts would grow by approximately three percent annually. Prior to the pandemic, electronic pull tab receipts were growing by an average of 10 percent annually; however, this growth rate was not used for projecting future electronic pull tab receipts because legislative changes from 2022 are expected to slow the growth of electronic pull tab receipts. The growth assumption used for electronic pull tab receipts was the same as the one used for historical horse racing machines receipts.

For horse race wagering, a 3 percent annual growth rate was assumed for traditional horse racing and historical horse racing (HHR) handle for 2023 through 2025, with adjustments for the anticipated opening of two new HHR facilities in 2023 and 2024. With traditional horse racing wagering (wagering on live races at the track and at simulcast location, and wagering on live races through advance deposit wagering), a consistent annual growth rate for the past several years could not be established because live racing resumed in Virginia in 2019, additional simulcast wagering locations opened throughout 2019 and 2020, and the pandemic impacted wagering throughout 2020. As a result, JLARC staff assumed that wagering in 2022 would be the same as in 2021 (as it recovered from the impacts of the pandemic), and then it would grow at a rate of 3 percent annually in 2023 through 2025.

For HHR, JLARC staff began by reviewing the handle per machine by HHR facility location. Handle per machine per day ranges from approximately \$2,500 in New Kent County to approximately \$6,400 at Dumfries. Then, JLARC staff assumed that handle per machine per day would grow by 3 percent by HHR facility. However, JLARC staff made some adjustments to this growth assumption for the expected opening of new HHR facilities. JLARC staff assumed that the new Emporia location would open in FY24 with 150 machines, a handle per machine per day equivalent to the average handle per machine across all HHR facilities, and would be open for all of FY24 (that would mean it opens on July 1, 2023). JLARC staff assumed that the second Dumfries location would open for the second half of FY24 (opens on January 1, 2024), and that the average handle per machine per day would be half of the average handle per machine per day at the current Dumfries location. JLARC staff also assumed that the average handle per machine per day at the existing Dumfries location would be reduced by 50 percent when the second Dumfries location opens. This assumption was made because

when Rosie's added machines to its Vinton location in December 2021, it saw handle per machine per day drop by 58 percent at that facility.

For lottery sales, JLARC staff assumed they would grow by approximately 6 percent annually for 2022 through 2025. This assumption was made because the average annual growth of lottery sales for 2015 through 2018 was 6 percent. Growth in 2020 and 2021 was excluded from the average because they were outliers with the pandemic impacting lottery sales in 2020 (lottery sales were 6 percent lower than the previous year), and iLottery was introduced in 2021 (lottery sales were 52 percent higher than the previous year).

For casino wagering, JLARC staff used the estimate produced by the Innovation Group (ITG) for the 2019 JLARC report. JLARC staff used the net gaming revenue estimates for the Bristol, Danville, Portsmouth, and Norfolk casinos, and assumed a casino win of 15 percent (amount the casino keeps after prizes are paid back to players). It was assumed that all four casinos will be open for a full year in 2025. For sports wagering, actual preliminary wagering data was used for 2022, and then it was assumed that wagering would grow by 3 percent annually in 2023 through 2025.

Appendix C: Agency responses

As part of an extensive validation process, the state agencies and other entities that are subject to a JLARC assessment are given the opportunity to comment on an exposure draft of the report. JLARC staff sent relevant sections of the exposure draft of this report to the Virginia Department of Agriculture and Consumer Services (VDACS), Virginia Lottery, Virginia Racing Commission (VRC), Virginia Alcohol Beverage Control Authority (ABC), and secretary of agriculture and forestry.

Appropriate corrections resulting from technical and substantive comments are incorporated in this version of the report. This appendix includes response letters from VRC, VDACS, Lottery, and ABC.



COMMONWEALTH of VIRGINIA

Virginia Racing Commission

Stuart C. Siegel, Vice Chairman
John F. Tanner Jr.
Marsha K. Hudgins
Stephanie B. Nixon
Bette Brand

David S. Lermond, Jr.
Executive Secretary

October 7, 2022

Mr. Hal E. Greer, Director
Joint Legislative Audit & Review Commission
919 East Main Street, Suite 2101
Richmond, VA 23219

Dear Mr. Greer,

Thank you for the opportunity to review and comment on the exposure draft report: *Oversight and Administration of Gaming in the Commonwealth*. The Virginia Racing Commission (VRC) is in agreement with the report and its recommendations. I also want to thank you for taking into consideration some of my comments and suggestions. Lastly, I would like to commend you and your hard-working staff for the professionalism, thoroughness, and cooperation that was demonstrated during this process.

The only concern I have would be the funding for the VRC if the regulation of Historical Horse Racing (HHR) is transferred to the VA Lottery. The VRC will still receive the state tax from traditional forms of pari-mutuel wagering, however, that will not be sufficient to cover the VRC's expenses for the regulation of live racing in the Commonwealth, especially given the expansion of live race days that will occur in the near future. The VRC currently receives .64% of the amount wagered through HHR and I would ask that a small portion of this percentage be directed to the VRC. We would only require .04% from HHR wagering to be able to properly regulate the expansion of live race days and of course, any unused revenue would be transferred to the General Fund at the end of each fiscal year as in the past.

If you should have any additional questions, please feel free to contact me directly.

Sincerely,

A handwritten signature in black ink, appearing to read "DL", with a long horizontal flourish extending to the right.

David Lermond
Executive Secretary



COMMONWEALTH of VIRGINIA

Department of Agriculture and Consumer Services

PO Box 1163, Richmond, Virginia 23218

www.vdacs.virginia.gov

Joseph W. Guthrie
Commissioner

October 7, 2022

Mr. Hal E. Greer
Director
Joint Legislative Audit and Review Commission
919 East Main Street, Suite 2101
Richmond, VA 23219

Dear Mr. Greer:

Thank you for the opportunity to review and comment on the draft *Oversight and Administration of Gaming in the Commonwealth* report. We appreciate the work conducted by your staff in completing this report and their efforts in understanding the complexities of Virginia's Charitable Gaming Law.

The Virginia Department of Agriculture and Consumer Services (VDACS) recognizes the benefits of combining the regulation of charitable gaming into a central agency that regulates other forms of gaming and VDACS has no objections to the recommendations in the report related to charitable gaming in the Commonwealth.

Thank you again for the opportunity to review and provide input on the draft *Oversight and Administration of Gaming in the Commonwealth* report.

Sincerely,

A handwritten signature in black ink that reads "Joseph W. Guthrie".

Joseph Guthrie
Commissioner



GLENN YOUNGKIN, GOVERNOR | KELLY T. GEE, EXECUTIVE DIRECTOR
Virginia Lottery | 600 E. Main St. | Richmond, VA 23219 | ph: 804.692.7100 | valottery.com

October 17, 2022

Hal Greer, Director
Joint Legislative Audit & Review Commission
919 East Main Street, Suite 2101
Richmond, VA 23219

Dear Mr. Greer:

Thank you for the opportunity to review and comment on the exposure draft report *Oversight and Administration of Gaming in the Commonwealth*. JLARC staff always operated with the utmost professionalism and thoroughness, and we appreciated the many opportunities to engage in constructive dialogue throughout this study.

The Virginia Lottery has worked purposefully to build out our expanded responsibilities to regulate casinos and sports betting in a transparent, integrity-driven way that adheres to industry best practices. That process is ongoing; in particular, three additional casinos are in the initial licensure phase and planning for the first renewal of sports betting operators' permits will begin this fiscal year. The significant dedication of resources and efforts required to stand up entirely new forms of gaming cannot be overstated.

We agree with JLARC's recommendation that the Lottery's mission and expertise make it best positioned to become Virginia's central gaming agency. As the report noted, the Lottery has seamlessly transformed from an enterprise agency focused on operating a lottery to an agency with the additional core mission of regulating gaming. We have done so while maintaining a positive workplace culture and with no shortcoming in agency operations.

We would apply the same high standards to drive successful results if assigned additional forms of gaming regulatory oversight. To safeguard the success of lottery operations and profits to support K-12 education and the continued constructive rollout of casino and sports betting oversight, the appropriate time and resources would be critical for success.

If the goal of decision-makers is to ensure effective and efficient regulation across multiple forms of gaming, with one agency serving as a single point of contact, the Virginia Lottery stands ready to assist in accomplishing that mission.

Respectfully,

Kelly T. Gee



October 6, 2022

Hal E. Greer, Director
Joint Legislative Audit & Review Commission
919 East Main Street
Suite 2101
Richmond, Virginia 23219

Dear Hal:

Thank you very much for the opportunity to review and comment on the exposure draft regarding skill games in the Commonwealth. We enjoyed our conversation with the folks who were investigating the history and potential future of skill games. They were fully engaged, asked important questions, and were truly interested in our brief history with regulating these games.

Based upon our review of the portions of the draft report shared with us, we do not have any technical corrections.

As you know, Virginia ABC did regulate these games for a brief period of time and while I believe we did an admirable job under the circumstances, our enforcement expertise is best focused in regulation of beverage alcohol and education of businesses and consumers in the Commonwealth.

Should these games return to legality in the Commonwealth, I agree with JLARC's conclusion that an organization already experienced in the regulation of gaming, such as the Virginia Lottery, is best suited to regulate the enterprise.

Again, many thanks for the opportunity to participate and comment and continued best wishes for the good work you and your staff accomplish.

Sincerely,

A handwritten signature in blue ink, appearing to read "Travis Hill".

Travis G. Hill, Esq.
Chief Executive Officer





JLARC.VIRGINIA.GOV

919 East Main Street Suite 2101 Richmond, VA 23219