

# Summary: Oversight and Administration of Gaming in the Commonwealth

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## 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

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## 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.

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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 become 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 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.

