

Oversight and Administration of Gaming in the Commonwealth

Study mandate

- Assess the advantages and disadvantages of consolidating gaming regulation into a single state agency, including:
 - evaluate the roles and responsibilities of each agency;
 - evaluate the effectiveness of each agency's gaming activities;
 - compare and contrast each agency's regulatory requirements, including licensing and inspection requirements;
 - consider how, if at all, consolidation could affect the various missions of each agency; and
 - examine other states' approaches to gaming regulation.

Commission resolution (January 2022)

Primary research activities

- Structured interviews
 - Staff at Virginia Lottery, VDACS, VRC, and other state agencies
 - Gaming experts, operators, and other stakeholders
- Review of internal agency documents
- Data collection and analysis
 - Staffing and workload analysis
 - Gaming revenue analysis
- Review of Virginia state laws and regulations for gaming
- Review of other states' gaming regulatory structures

In brief

Legal gaming has expanded rapidly in Virginia.

VRC does not have adequate staffing, regulations, or policies to sufficiently regulate historical horse racing.

VDACS is not adequately staffed to sufficiently regulate charitable gaming.

Establishing a single state gaming agency would facilitate effective and efficient regulation across all gaming formats, and Virginia Lottery is best suited to serve in this role.

If a single state gaming agency is not established, additional resources will be needed at VDACS and VRC to sufficiently regulate charitable gaming and historical horse racing.

In this presentation

Background

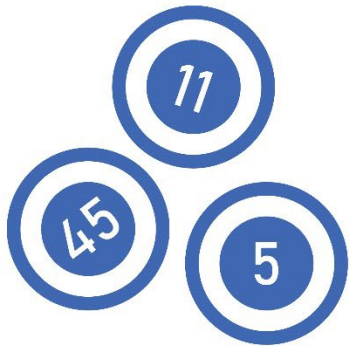
Regulating wagering on horse racing

Regulating charitable gaming

Unregulated electronic gaming machines

Creating a central gaming agency

Before 2019, Virginia permitted three types of gaming



Lottery

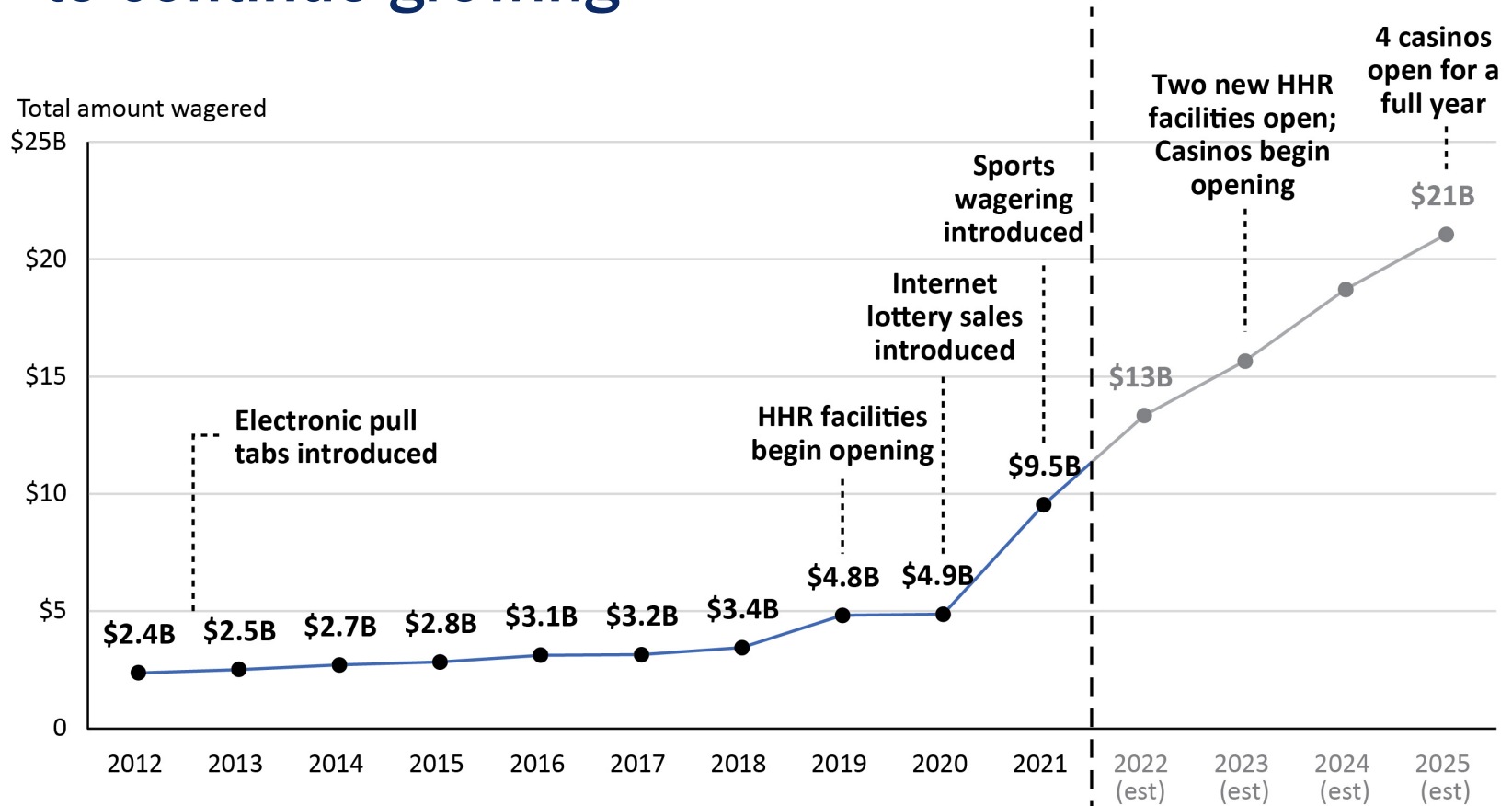


Charitable gaming



Horse race wagering

Wagering has tripled since 2018 and is expected to continue growing



Source: JLARC staff analysis of data from VRC, Office of Charitable and Regulatory Programs (OCRP), Lottery, and the 2019 Innovation Group report on expected gaming revenue.

Note: Figures are adjusted to 2021 dollars.

Most gaming offers wagering through electronic gaming machines

Slot machines
~900



Electronic pull
tab machines
~3,300



Historical horse
racing machines
~2,600

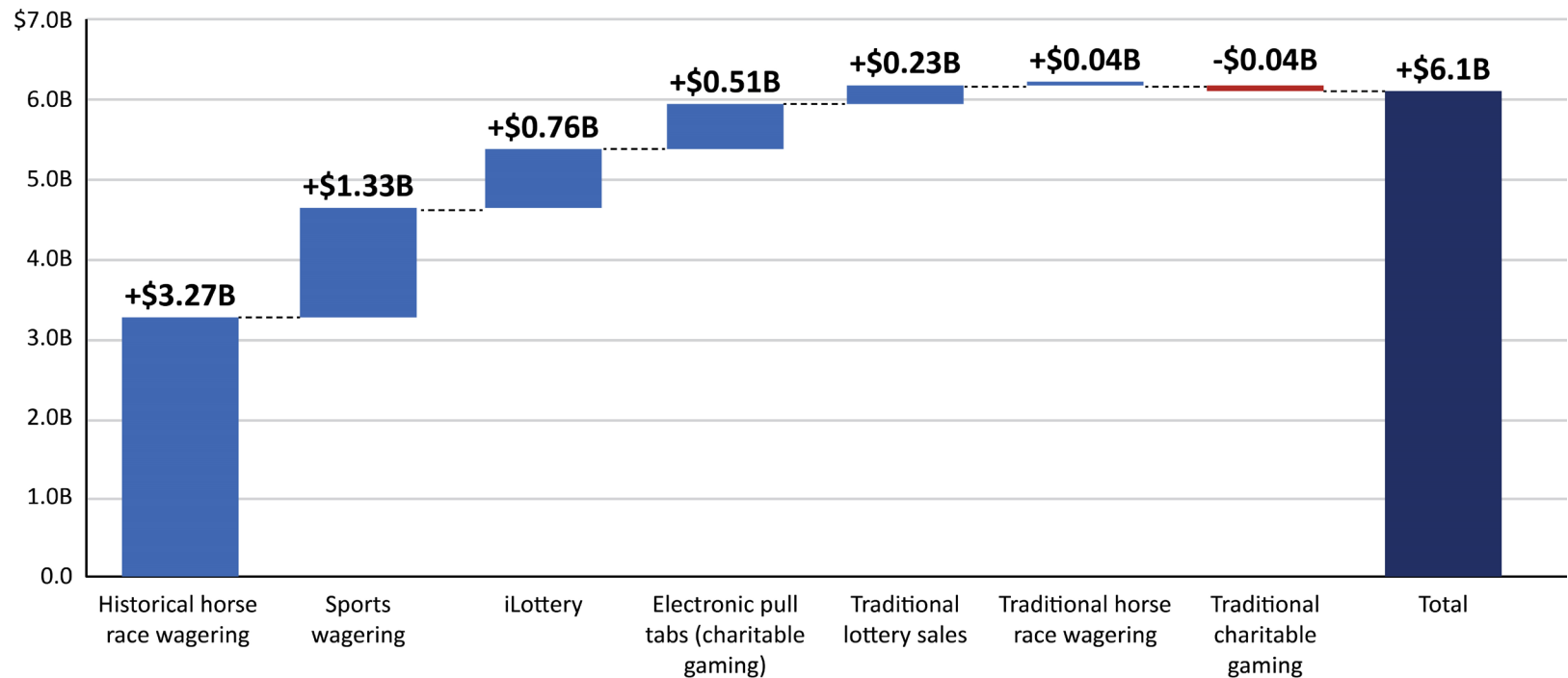


Gray machines
~9,100



Sources: (Clockwise from top left) Virginia Lottery, OCRP, JLARC staff.

Growth in wagering on historical horse racing machines accounts for most growth in wagering






Note: Includes wagering growth between 2018 and 2021

Source: JLARC analysis of VRC, OCRP, and Lottery data

Gaming generates funds for education, charitable organizations, horse industry, and governments

- Lottery sales generated \$767M for public K–12 education in 2021
- Charitable gaming generated ~\$77M for charitable organizations in 2021
- Horse race wagering generated ~\$30M for various horse racing interests in 2021
 - Horse race wagering operators also paid ~\$27M in state taxes and ~\$16M in local taxes in 2021
- Sports wagering operators paid ~\$8M in state taxes in 2021

Three agencies regulate gaming in Virginia

	 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	267 (Lottery functions); 69 (gaming compliance)	11	4.5
Appropriation	\$164 million (Lottery); \$23 million (gaming)	\$2.1 million	\$4.6 million

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

Note: Lottery and VRC (Virginia Racing Commission) appropriations funded with gaming proceeds; OCRP appropriation comes from general fund but is largely offset by registration and permitting fees paid by charities.

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Most wagering on horse racing is through historical horse racing (HHR)

- As of 2021, 95 percent of wagering on horse racing was through HHR
- Six HHR facilities with over 2,600 machines
 - Each HHR facility has between 37 and 700 machines
 - HHR facilities employ ~1,100 people
- Two additional HHR facilities are under construction
 - Emporia location will have 150 machines
 - Second Dumfries location will have up to 1,200 machines
- State law allows up to 5,000 HHR machines to operate in the state

HHR 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



HHR carries most of the same risks as casinos

Gaming characteristics	Increases risk for:	HHR	Casinos
High wagering amounts	Money laundering; financial crimes; theft; fraud; cheating	\$3.4B	\$4.5B
Available throughout state	Problem gambling	✓	✓
Electronic gaming machines	Problem gambling; money laundering; financial crimes; theft; fraud; cheating	✓	✓
Dining, entertainment, hotel	Problem gambling; ancillary crimes	✓	✓
Table games	Cheating; theft		✓

Finding

VRC does not have adequate staffing, expertise, or licensing and operating regulations or policies to sufficiently regulate historical horse racing.

VRC commissioners and staff lack relevant experience to regulate HHR

- Effective gaming governance boards and staff have experience in certain fields (such as accounting, law, and law enforcement) or commercial gaming
- VRC board and staff do not have commercial gaming expertise
- VRC commissioners typically have personal or professional interest and expertise in Virginia's horse industry
 - VRC staff have expertise in horse racing, animal welfare, and traditional pari-mutuel wagering

VRC does not have nearly enough staff to adequately regulate HHR

- VRC employs 4 full-time employees and 1 part-time employee year-round
- Part-time staff member is the only employee dedicated to regulating HHR
- Adequate HHR regulation would require at least 15 additional employees for current number of HHR facilities
 - At least 7 additional regulatory employees will be needed when additional HHR facilities open, for a total of 22 employees

Licensing practices should follow industry standards

- Casino licensing standards are appropriate for HHR facilities
- Industry standards for casino licensing include:
 - licensing key executives, gaming suppliers, and employees;
 - arranging licensing requirements in a risk hierarchy;
 - independently verifying applicants' information; and
 - conditioning operator license issuance on compliance with state laws, regulations, and other policies for operation

VRC's licensing requirements for HHR lack some key elements

- Operations and security managers not considered key executives and not required to submit personal and financial information
- Insufficient information required for key executive licensure and gaming equipment supplier licensure
- Personal and financial information is not independently verified by VRC
- HHR facilities are not required to meet any pre-opening requirements for licensure

VRC regulations do not address all gaming compliance risks

- Casino regulations typically include rules for a casino's day-to-day operations, financial accounting, and technology
- Regulations also typically provide clear mechanisms to ensure compliance through enforcement
- VRC's compliance regulations do not address key risks; for example, they do not
 - require submission or approval of internal controls for key processes, such as cash drops or jackpot payouts; or
 - require supervision of installation, start-up, and movement of electronic gaming terminals

Recommendation

HHR regulations should be developed for

- licensing HHR facilities, operator, and employees that incorporate best practices for casinos, and
- HHR operations that ensure risks are effectively minimized, including internal control requirements, regular inspections, and enforcement mechanisms.

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Charitable gaming exists to generate revenue for charitable organizations

- Includes traditional charitable gaming (i.e., bingo, paper pull tabs) and electronic pull tabs
- Less risky than casino and horse race wagering because of smaller operational scale
- State regulation necessary because charities typically do not have expertise in gaming
 - Average of \$5 million in wagering per charity in 2021
 - Games typically run by volunteers

Finding

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

VDACS regulates charitable gaming through permitting, inspections, and audits

- Licenses charitable organizations, suppliers, gaming managers
- Conducts inspections to ensure games run properly, charity meets gaming requirements
- Audits organizations' charitable gaming accounts to determine if charities earn and use revenue in accordance with state law

VDACS is not meeting internal audit and inspection goals

- OCRP aims to conduct 3 to 4 inspections per charity, on average, per year
 - In 2020, it conducted 1 to 2 inspections per charity
- OCRP aims to audit charities once every 3 years
 - In 2020, OCRP audited charities at a rate of once every six years

Expanded responsibilities will exacerbate existing staffing shortages

- New oversight responsibilities related to charitable gaming include
 - Oversight and enforcement authority for electronic pull tab wagering and social quarters
 - Texas Hold 'Em poker tournaments
- VDACS will need at least 26 employees to adequately regulate charitable gaming but currently has only 11 filled positions

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Findings

“Gray machines” produce substantial wagering statewide but likely reduce wagering on Virginia’s authorized forms of gaming.

Machines are not currently regulated, which creates risks for players and business owners who host the machines.

Gray machine wagering is substantial

- Gray machines are electronic gaming devices in retail locations and bars
 - General Assembly has prohibited gray machines
 - Pending court case and injunction allow them to continue operating
- Over 9,000 machines operating in the state
 - Estimated wagering in FY21 = \$2.2B
 - Estimated net gaming revenues* in FY21 = \$507M
- Machines continue to operate, and net gaming revenue is not currently taxed

*Net gaming revenue refers to the amount wagered minus prizes awarded.

Number of machines may continue to grow

- Number of machines could grow to more than 19,000 if they continue to operate unregulated
- If gray machines are permitted to operate legally, state could regulate them and limit:
 - the number of machines per location;
 - the number of machines statewide;
 - the types of businesses that can host machines; and
 - the types of prizes that machines can offer.

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Creating a central gaming agency

Some states have consolidated gaming regulation as legal gaming has expanded

- New York State – established a single umbrella agency to regulate all gaming
- Michigan – gaming control board regulates casinos, horse race wagering, some charitable gaming, and sports wagering
- Indiana – gaming commission regulates casinos, charitable gaming, sports wagering, and commercial gaming at racetracks

Central gaming agency can focus on gaming regulation

- Concentrates regulatory staff's knowledge and understanding of the gaming industry in one place
- Consolidating IT components of gaming regulation creates efficiency opportunities
- Ensures the state's problem gambling prevention and treatment efforts are robust, consistent, and coordinated
- Creates a logical “home” for regulating any future forms of legal gaming

Regulating HHR through a central agency could address current shortcomings

- VRC is not focused on regulating large-scale commercial gaming, which HHR facilities have become
- VRC has not promulgated licensing and operations regulations to mitigate risks of HHR facilities and machines
- VRC's licensing applications are not automated
- VRC has not actively participated in statewide problem gambling prevention and treatment coordination with DBHDS

Increasing VRC's capacity to adequately regulate HHR would be a challenge

- VRC staff require specialized technical knowledge to understand and apply the rules of horse racing and pari-mutuel wagering
 - e.g., determining whether a horse obtained a fair start, understanding which medications are permitted, determining how to test horses for medications, directing when and how wagering should be terminated
- Quadrupling VRC's staffing would materially change the focus and culture of VRC
- Staff and commission members' time and attention would have to shift away from live racing to some degree

State law requires HHR revenues to support the horse industry, regardless of regulatory structure

- State law and VRC regulations require HHR operator to hold one live race day per 100 HHR machines
- Appropriation Act requires a portion of HHR revenues to be distributed to certain horse industry interests
 - Revenue sharing agreement distributes a portion of HHR revenues to the horse industry
- HHR operator license from Lottery should be contingent on being licensed for live horse racing by VRC
 - Ensures that, regardless of which entity regulates HHR, HHR continues to operate for the benefit of live racing and the horse industry

Regulating charitable gaming through a central agency could address some issues

- Regulating charitable gaming is only a minor function for VDACS
- VDACS has historically had difficulty recruiting for charitable gaming positions
- VDACS's authority for charitable gaming regulation is expanding
 - Jurisdiction over electronic pull tab machines and social quarters
 - Beginning to allow Texas Hold 'Em poker tournaments
 - Staff will have ability to suspend, revoke, or deny licenses

Creating a new agency as the central gaming agency has drawbacks

- Lottery has already developed a regulatory program for casinos and sports wagering
 - Hired approximately half of the staff they will need (~70 employees)
 - Lottery is in the process of licensing and opening casinos, which will be ongoing for at least the next 3 years
 - Moving this section out of the agency would create uncertainty and disruption for Lottery's employees and casino operators
- Creating a new agency would require establishing a new leadership team at that agency, rather than using the existing leadership structure at Lottery

Virginia Lottery could serve as a central gaming agency

- Virginia Lottery is best positioned to serve as a central gaming agency because:
 - Gaming regulation is the Lottery's primary mission;
 - Agency does not appear to have any major shortcomings in operations;
 - Lottery recently implemented a regulatory framework for casinos and sports wagering; and
 - Lottery has a licensing system that is capable of being modified for additional forms of gaming.

Recommendations

The General Assembly may wish to consider:

- Maintaining VRC as the regulatory entity for live horse racing;
- Designating Virginia Lottery as the state's central gaming agency;
- Transferring responsibility for regulating HHR to Virginia Lottery;
- Transferring responsibility for regulating charitable gaming to Virginia Lottery.

Horse racing and charitable gaming interests should be represented on Lottery board

- Include a VRC member and a Charitable Gaming Board member on the Lottery board
- Charitable Gaming Board should continue to exist as an advisory board to the Lottery board

Recommendation

If the Virginia Lottery is given responsibility for regulating HHR and charitable gaming, the General Assembly may wish to consider adding two new, voting, ex-officio positions to the Lottery Board,

- one position to be filled by a member of the VRC, and
- one position to be filled by a member of the Charitable Gaming Board.

Recommendation

If the Virginia Lottery is given responsibility for regulating HHR and charitable gaming, the General Assembly may wish to consider requiring

- the Charitable Gaming Board to become an advisory board to the Lottery board, and
- issuance of an HHR operator's license to be contingent on the license applicant having first been granted a "significant infrastructure limited license" to conduct live horse racing from the VRC.

Cost of effectively regulating HHR can be paid for through existing tax on HHR wagering

- VRC's regulatory costs are currently paid for through state tax on HHR wagering
 - Of the \$31M collected in 2022, VRC used \$1.5M to fund horse race wagering regulation (which included HHR)
- Cost of more robust HHR regulation is ~\$2.2M – over \$25M in HHR wagering tax revenues to revert to GF
- Proceeds to horse industry are taken out of gaming revenue before state taxes, so increased regulation costs do not diminish funds to horse industry

Cost of effectively regulating charitable gaming would require increasing fees to 2020 level

- Charities pay fees for permits, licensing, and administration
- 2022 General Assembly lowered fee from 1.375% of gross gaming revenues to 0.75%
- Audit and administration fee would need to increase to 1.4% (from 0.75%) to fully fund cost of regulation (~\$3.5M)
 - Once Texas Hold 'Em poker tournaments begin, regulator should assess whether fee would need to increase further to cover costs of regulation

Key findings

Legal gaming has expanded rapidly in Virginia.

VRC does not have adequate staffing, regulations, or policies to sufficiently regulate historical horse racing.

VDACS is not adequately staffed to sufficiently regulate charitable gaming.

Establishing a single state gaming agency would ensure effective and efficient regulation across all gaming formats, and Virginia Lottery is best suited to serve in this role.

If a single state gaming agency is not established, additional resources will be needed at VDACS and VRC to sufficiently regulate charitable gaming and historical horse racing.

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