JLARC
JOINT LEGISLATIVE AUDIT AND REVIEW COMMISSION

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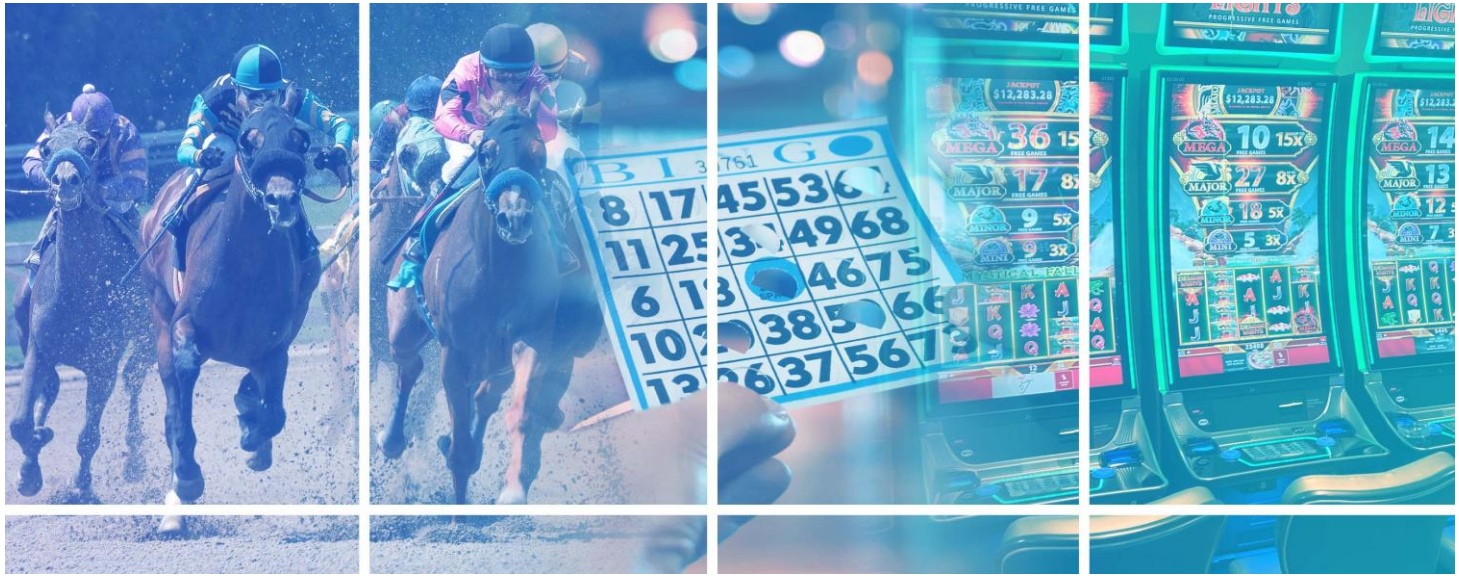


Oversight and Administration of Gaming in the Commonwealth

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)

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.

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

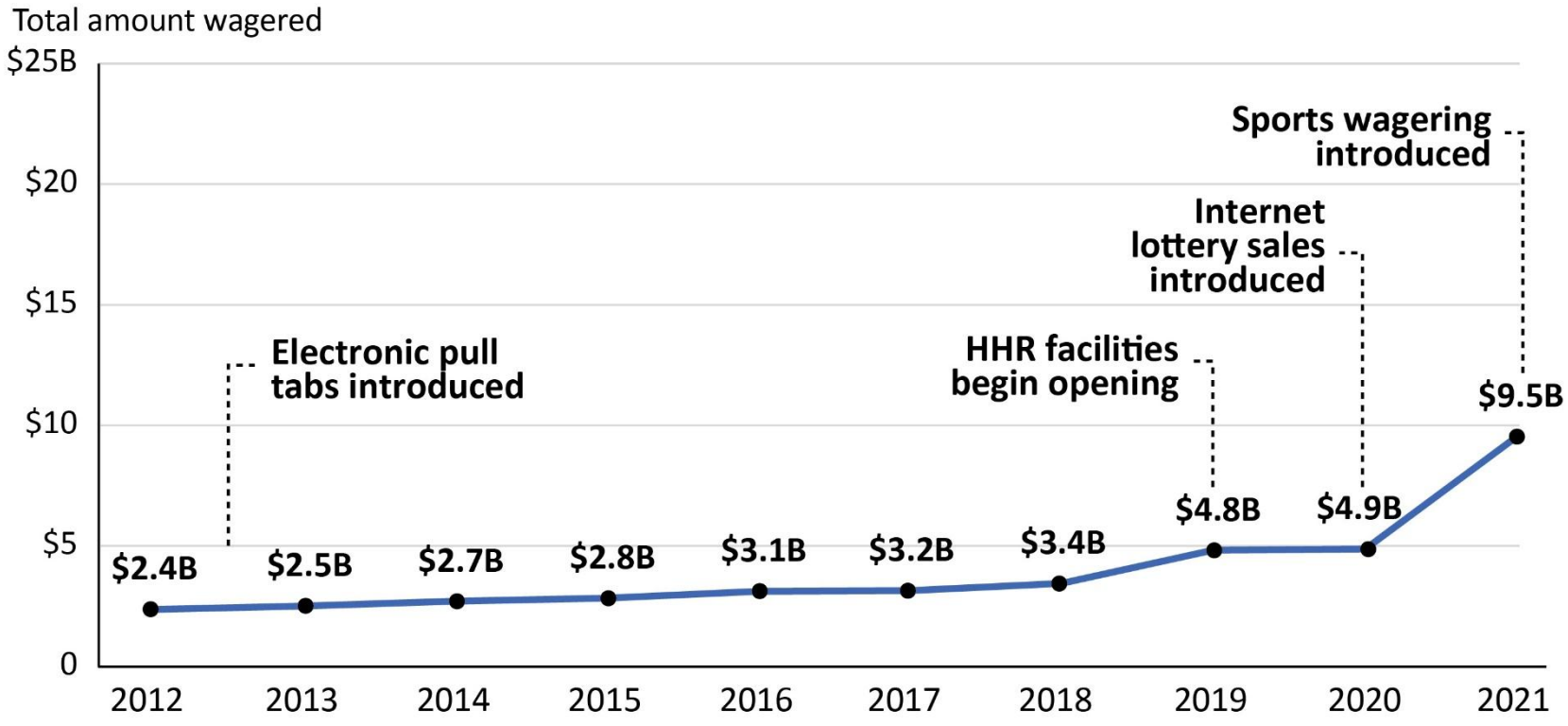
Regulating wagering on horse racing

Regulating charitable gaming

Unregulated electronic gaming machines

Creating a central gaming agency

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
~3,200

Electronic pull tab machines
~3,300

Historical horse racing machines
~2,800

Gray machines
>9,000

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

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	▪ Independent agency ▪ Seven-member policy board	▪ Executive branch agency (VDACS) ▪ Nine-member advisory board	▪ 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, FY22.
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)

- 96 percent of wagering on horse racing is through HHR
- Seven HHR facilities with nearly 2,800 machines
  - Each HHR facility has between 37 and 700 machines
  - HHR facilities employ ~1,100 people
- One additional HHR facility is under construction in Dumfries
  - Will include ~ 1,100 machines, hotel, other amenities
- 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	$4.0B	$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		✓

*Projected for casinos

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

*As of October 2022, JLARC's final report date.

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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Creating a central gaming agency

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 has only 11 filled positions*

* As of JLARC’s October 2022 report date.

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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.

**VA Supreme Court overruled lower court's injunction on 10/13/23.

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Creating a central gaming agency

In most states, gaming regulation has evolved on a fairly ad hoc basis, similar to Virginia

- As states legalize different forms of gaming, the approach taken to regulate it at the state level evolves in response
  - In many states gaming regulation has unfolded such that different agencies become involved, like in Virginia
  - Gaming regulation is not necessarily the primary function of those agencies
- Some states have consolidated regulation of at least some types of gaming into a specialized agency
  - JLARC's 2019 report on casinos and sports wagering recommended assessing the need for consolidation after casinos become operational

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
- Other states regulate through multiple agencies but, over time, consolidate gaming into fewer agencies

Central gaming agency has clear advantages

- Concentrates regulatory staff's knowledge and understanding of the gaming industry in one place
  - Over time, staff can become highly skilled, specialized in regulating different forms of gaming
  - Facilitates cross-training, which is important as regulatory demands of gaming grow
- Consolidates IT components of gaming regulation, which creates efficiency opportunities (e.g. procurement, system modifications, end-user experience)
- 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

Lottery could serve as a central gaming agency

- Potential conflicts of interest appear to have been managed well; enterprise and regulatory divisions are separate and distinct
- Recently implemented a strong regulatory framework for casinos and sports wagering
- Licensing system is capable of being modified for additional forms of gaming
- As an independent agency, Lottery has some flexibilities (HR, procurement) that allow it to act more quickly
- JLARC's consultants and other experts indicate that lottery agencies can effectively oversee other forms of gaming

Regulating new forms of gaming would expand Lottery's mission and workload

- Lottery would experience further workload expansion, on top of expansion related to regulating casinos and sports betting
- Additional changes to lottery board would be needed to govern other forms of gaming

Stand-alone agency is another option

- While other states that administer gaming through lottery agencies have handled potential conflicts of interest—and Lottery has succeeded in doing so thus far—conflict of interest is a valid concern
- Leadership of stand-alone agency could make decisions based solely on its responsibility to monitor and enforce the gaming operators' compliance with the law
- Stand-alone agency may require more staff resources for HR, finance, legal, and IT compared to centralizing under Lottery
- Requires new leadership structure and transfer of many Lottery employees

State-level gaming policy office is needed

- Responding to rapidly evolving gaming industry has been challenging for lawmakers, agency staff, local governments
- State policy office would build state-level expertise on gaming, including new and emerging trends and technologies
- Could issue regular reports to the General Assembly
  - Potential actions lawmakers and other state officials could take to respond to emerging trends and to continually improve gaming regulation

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
  - Commission meetings focused almost exclusively on live racing
- 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

Recommendations

The General Assembly may wish to consider:

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

Other considerations

- Horse racing and charitable gaming interests should be represented on the Lottery board if functions are transferred
  - 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
- Issuance of an HHR operator's license should be contingent on the license applicant having first been granted a "significant infrastructure limited license" to conduct live horse racing from the VRC, which would maintain VRC's involvement in key HHR decisions

Other considerations (cont'd)

- Cost of effectively regulating HHR can be paid for through existing tax on wagering
  - Cost of ~$2.2M compared with over $25M in tax revenue reverted to GF
- Cost of effectively regulating charitable gaming could be paid for through increase in audit and administration fee
  - Increase fee back to pre-2022 levels (~1.4% of gross gaming revenues, versus current 0.75%)