

**Report on the Possible Authorization of Exchange Wagering
Pursuant to Senate File 438**



**Submitted to:
Iowa General Assembly
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Executive Summary

Legislation (SF 438) was enacted and signed in April 2015 directing the Iowa Racing and Gaming Commission (IRGC) to study the topic of exchange wagering and report the findings to the Iowa Legislature by December 1, 2015. The intent of the report is to provide policy-makers with information so they are able to make an informed decision concerning the possible authorization of exchange wagering.

It is important to understand some key industry terms when discussing exchange wagering. *Exchange wagering*, as defined by SF 438, is a form of wagering in which two or more persons place identically opposing wagers in a given market. It allows customers to wager on both winning and non-winning outcomes in the same event so long as customers are willing to accept the odds offered by each side of the outcome. *Pari-mutuel wagering*, as defined in Iowa law, means the system of wagering as described in 99D.11. In practice, pari-mutuel wagering is a betting system that creates a pool of money based on possible winning outcomes at a racetrack. The racetrack takes a fee (or takeout) of the pool and distributes the remaining money in the pool to winners based on a proportion of their wagers. *Advanced deposit wagering (ADW)*, as defined in 491 IAC 8.1, is a method of pari-mutuel wagering in which an individual may establish an account, deposit money into the account, and use the account balance to pay for pari-mutuel wagering. ADW takes place over the internet using a computer or mobile device. Exchange wagering would likely take place on an ADW platform.

The report considered the current state of exchange wagering by surveying industry participants who are familiar with the subject, by reviewing current events in New Jersey and California where exchange wagering is legal but not operating, and by researching foreign jurisdictions where exchange wagering is legal. The current state of pari-mutuel wagering in Iowa was discussed as part of this report in an effort to understand the history of pari-mutuel wagering in Iowa, in addition to considering the successes and challenges related to pari-mutuel wagering in Iowa. The potential revenue impact of authorizing exchange wagering was reviewed in an effort to understand if or how much of an impact the potential addition of exchange wagering will have on purses (total amount of money paid out to the owners of a racing animal), operator's revenue, and taxes for the State of Iowa. Lastly, extensive research was conducted and reported in the area of consumer protection, including but not limited to, identity and age verification, network security, auditing of wagering software, race integrity and making 'lay' and in-play wagers, and licensing of entities participating in the industry.

Exchange wagering occurs in many European countries and Australia on web-based betting exchanges. The exchanges exist for consumers to place wagers at the prices and odds of the consumer's choice with an identically opposing wager needed to match the wager in a given market. Web-based betting exchange operators use technology to match supply and demand wagers on a wide range of activities including horse racing, sports markets, and entertainment. A valid matched wager is formed when two or more persons are confirmed by the exchange operator as having identically opposing wagers in a given market. A web-based exchange provides consumers a unique wagering opportunity as compared to traditional methods of wagering.

In the United States, exchange wagering is statutorily authorized in California and New Jersey for pari-mutuel horse racing only. New Jersey has set forth rules and regulations for exchange wagering at Monmouth Park and the Meadowlands Racetrack facilities. One online betting exchange, Betfair, is currently undergoing New Jersey's licensing process to operate the first web-based exchange wagering platform. California's exchange wagering is currently on hold due to disagreements between stakeholders in the horse racing industry. Although statutorily authorized, neither jurisdiction has yet to accept an exchange wager.

In 1983, the Iowa Legislature passed the Pari-Mutuel Wagering Act allowing for qualifying organizations to apply for a license to conduct pari-mutuel wagering on horse and dog racing. In 1984, four facilities were issued licenses. The four licensees were the Racing Association of Central Iowa (Prairie Meadows), National Cattle Congress (Waterloo Greyhound Park), Dubuque Racing Association Ltd (Dubuque Greyhound Park), and the Iowa West Racing Association (Bluffs Run). In 1989 simulcasting, the telecasting of live audio and visual signals of pari-mutuel races received from an authorized racing facility for the purpose of pari-mutuel wagering was enacted.

The early 90's brought difficult times for pari-mutuel racing operations in Iowa due to some decline in wagering caused by competition from racing and casino gambling in adjacent states resulting in Prairie Meadows and Waterloo Greyhound Park filing for bankruptcy. In March 1994, the Iowa Legislature enacted legislation to allow racetrack enclosures existing in January 1994 to allow certain gambling games if approved by local referendum. As a result, racinos, racetrack facilities with gambling games, came into existence at Dubuque Greyhound Park, Bluffs Run, and Prairie Meadows. This increased profits, allowed for debt repayment,

charitable contributions, and the funding of community projects. The racino concept in Iowa has been a model used throughout the United States due to its success. In 2011, ADW was approved at Prairie Meadows and implemented in 2012. Legislation was enacted in 2014 allowing for Dubuque Greyhound Park and Bluffs Run to continue to offer casino gaming without the requirement to conduct live greyhound racing. Dubuque Greyhound Park ended live greyhound racing in 2014. Bluffs Run will end greyhound racing in December of 2015. Also pursuant to the 2014 legislation, a license was issued in 2015 to the Iowa Greyhound Association to conduct live greyhound racing in Dubuque without casino gaming.

The live racing handle (total amount of money wagered) and simulcast wagering at the licensed racetrack facilities started strong when operations began. A gradual downward trend has continued to date for the live track handle and simulcast export (wagering on simulcast signals sent by Iowa racetracks). Simulcast import wagering (wagering on simulcast signals received at Iowa racetracks) had its highest handles in Iowa in the early 1990's. Following this period of time, simulcast import wagering began a downward trend which continues to date.

Revenues from exchange wagering are generated in a different manner than traditional pari-mutuel wagering. With exchange wagering, a commission is charged on either the net winnings or bet winnings of the customer depending on how the operator or jurisdiction elects to charge a customer. A net winnings model, where a commission is charged on the customers overall winnings from the market or pool, encourages greater liquidity for the exchange. However, it would likely generate lower overall revenues compared to a bet winnings model where commissions are charged on each winning back and lay wager within the race. There also is debate in the industry whether exchange wagering will grow overall wagering revenues.

Some people in the industry believe the commissions charged for exchange wagering are far less than the take out of pari-mutuel wagers. Concerns are customers will shift their spending to lower revenue generating exchange wagers resulting in a possible decline of overall revenues. Others in the industry believe exchange wagering will attract new customers to horse racing, therefore any cannibalization of higher revenue generating wagers would be replaced and exceeded from this new customer base.

There is no precedent for exchange wagering in the United States to assist with projecting revenues in Iowa. In addition, the stakeholders interviewed for this report did not offer any opinions with respect to projecting revenue. IRGC staff prepared a model, making a number of assumptions identified in the report, which demonstrates how revenues correlated to mutuel handle. The model may assist policy-makers in understanding the different stakeholders that would receive revenues from exchange wagering and how much would reasonably flow to horse racing purses and track operator revenues in Iowa depending on the amount of handle received from exchange wagering. IRGC staff believes the model is a reasonable representation of what can be expected, however this representation should be considered for what it is; a representation based on a number of assumptions with no precedent to directly rely upon.

It is also unclear if the State of Iowa will receive tax revenues as a result of adding exchange wagering to the current wagering options at Prairie Meadows. Iowa Code 99D.15 currently calls for a tax of six percent on the gross sum wagered by the pari-mutuel method, and further allows for a tax credit of six percent if the gross sum wagered is below \$90 million in one year. Tax implications for Iowa, with respect to exchange wagering, are unclear due to the following reasons: 1) revenue for exchange wagering is based on net or bet winnings and not

gross sum wagered, 2) the belief that exchange wagering is different than pari-mutuel wagering, 3) it is difficult to project if enough wagering will occur for Prairie Meadows to exceed the \$90 million amount that allows for a credit of taxes paid. IRGC recommends if exchange wagering is authorized in Iowa, Iowa Code 99D.15 should be amended to clarify if or how exchange wagering would factor into the pari-mutuel tax.

Consumer protection was researched and the development of licensing standards for companies and individuals participating in the gambling operations will be an important part of the regulation for exchange wagering. IRGC staff should conduct suitability checks on participating companies and their key employees. Background investigations should include criminal and financial reviews to ensure the public the exchange operator is qualified to receive a license in Iowa.

IRGC staff has previously worked with industry participants to develop uniform standards that relate to the prevention of problem gambling. Prevention of underage gambling, as well as the ability for problem gamblers to limit or withdraw themselves from gaming activity, is included in these standards. Research has indicated that in an online environment, many companies do have technology that can help in age and personal identification. IRGC should require the exchange operator to have software in place to ensure the exchange functions as designed in regards to determining age and personal identification of people wagering on the exchange.

Wagering via the internet does bring to the forefront concerns regarding identity theft, financial account security, and money laundering. In the past, IRGC has contracted with GLI and BMM to provide independent testing and verification of various software and hardware

components involved with slot machine and table game operations. IRGC should again utilize GLI, BMM, or other independent companies to ensure the exchange operator has quality control processes and products in place that can detect the aforementioned activity and limit or stop it completely.

A unique aspect of exchange wagering and subsequent concern of the public is the potential of possible manipulation in a race. ‘Lay’ betting (betting a horse to lose) is a new idea and an integral part of exchange wagering. One potential way to address this concern is to limit who can place lay bets. The regulatory authority can enact rules prohibiting any licensee who has a direct connection to a horse from making lay wagers. A review of regulatory rules in California and New Jersey show a list of licensees that could be restricted from making lay wagers including: jockey or the rider of a horse, trainer/assistant trainer, veterinarian, valet or stable employee, owner of horse, or anyone directly associated with these groups who may have knowledge of a horse’s condition that isn’t known to the public. This specific concern is equivalent to insider trading in the stock exchange. Another aspect of exchange wagering is allowing in-play wagering which is making wagers after the start of a race and before the race has been declared official. This option allows bettors the opportunity to hedge previous bets based on real time information at new market odds that are updated continuously. IRGC’s research has noted a concern with in-play wagering, specifically that delays in receiving video feeds could cause some advantage to players with real-time or quicker transmissions of video. An additional concern could be the use of gambling bots. Gambling bots are software which can be used on the gambling exchange to help speed up the process of evaluating information and placing subsequent wagers.

The research conducted by IRGC staff revealed some areas where information was difficult to obtain or seemed to be contradictory. Specifically, IRGC staff discovered conflicting answers as to how much or which segments of the horse racing industry will benefit from exchange wagering. This is best demonstrated by the varying positions of policy-makers in the two states where exchange wagering is legal in the United States (California and New Jersey). It should also be noted the revenue projections used in this report included a number of assumptions in an effort to provide some guideline for how increased handle translates to income. It would be beneficial to further study these assumptions along with receiving additional information on the topic of revenue.

Further information on the topic of in-play wagering and automated wagering software may also be needed as both topics, at the projected volume utilized in exchange wagering, would be new to industry participants in Iowa and many gambling jurisdictions across the United States. In-play wagering produces additional wagering opportunities for customers that are not offered in traditional pari-mutuel wagering. These wagers may generate additional interest and revenue; however it is possible to gain an advantage viewing races live versus having some delay via a simulcast link. Automated wagering software is something that is encouraged in exchange wagering to keep pools liquid. This is something that appears to be common in stock and commodity trading and could bring high interest and revenues for those not currently participating in pari-mutuel wagering. Additional thought and research may be needed to understand how automated software interacts with the exchange wagering system to ensure all customers are receiving similar access.

As stated earlier, the concept of exchange wagering is totally new to markets in the United States. As of the publishing of this report, no jurisdiction in the United States has actually implemented the concept of exchange wagering. Much of IRGC's research is based on interviews of potential participants that may emerge in future gambling markets. Since there is little or no historical data, many of the conclusions drawn are "best guesses" and may or may not come to fruition. IRGC staff will keep abreast of current and future events and continue to monitor the landscape in the United States as it relates to exchange wagering. When exchange wagering goes live in New Jersey, this will give all stakeholders an opportunity to look at true data and re-evaluate previous conclusions and update them as necessary.

Definition of the Report

Senate File 438

The state racing and gaming commission shall conduct a study concerning the possible authorization of exchange wagering, a form of wagering in which two or more persons place identically opposing wagers in a given market, as a form of pari-mutuel wagering in Iowa. The study shall consider the current state of pari-mutuel wagering in Iowa, the potential revenue impact of authorizing exchange wagering, the possible regulatory framework necessary if exchange wagering is authorized for licensees regulated under chapters 99D and 99F, including any necessary consumer protections, the manner of collecting wagering taxes for exchange wagering, and the general impact of authorizing exchange wagering as a form of pari-mutuel wagering. In conducting the study, the commission shall consult with the Iowa horsemen's benevolent and protective association, and may consult with the horse racetrack located in Polk county and any other parties the commission deems necessary. The commission shall submit a written report on its findings to the general assembly by December 1, 2015. The commission is not required to make specific recommendations regarding the legalization of exchange wagering in Iowa. The cost of the study shall be treated as an additional cost to the racing and gaming commission.

Background. Senate Study Bill 1256 was first recorded in the Iowa Legislature on March 4, 2015 (Iowa Legislature, n.d.). The bill had three parts. The first part required the Iowa Racing and Gaming Commission (IRGC) to conduct a study concerning the possible authorization of exchange wagering. This part further defined exchanged wagering as a form of wagering in which two or more persons place identically opposing wagers in a given market as a

form of pari-mutuel wagering in Iowa. In addition, this part identified various considerations to be included in the study. The second part of the bill required IRGC to consult with the Iowa Horsemen's Benevolent and Protective Association, Prairie Meadows Racetrack and Casino, and any other parties IRGC deems necessary. The last part of the bill directs IRGC to complete and submit their report to the general assembly by December 1, 2015, and further states IRGC is not required to make specific recommendations regarding the legalization of exchange wagering. Senate Study Bill 1256 was approved by the State Government Committee on March 5, 2015, and was introduced to the Senate on March 9, 2015, as Senate File 438 (Iowa Legislature, n.d.). Senate File 438 passed the Senate on March 18, 2015, passed the House on April 14, 2015, and was signed by the Governor on April 24, 2015 (Iowa Legislature, n.d.).

Industry Terms. As used in this report:

- Pari-mutuel: is a betting system that creates a pool of money based on possible winning outcomes at a race track. The track takes a fee (or takeout) out of the pool and the remainder is paid to all winners based on a proportion of their wagers. Iowa code defines "*pari-mutuel*" as a system of wagering as described in 99D.11 of the Iowa Pari-Mutuel Wagering Act.
- Exchange Wagering: is person-to-person betting. One person offers their own price for a given event and another person can decide to accept it. The exchange operator takes a percentage from each winning wager. In many ways, an exchange is similar to the stock market and offers options that standard pari-mutuel wagering doesn't. Bettors may wager on both winning and losing outcomes in the same race and may wager during a race until the outcome is declared official. Iowa Senate File 438 defines "*exchange wagering*" as a

form of wagering in which two or more persons place identically opposing wagers in a given market.

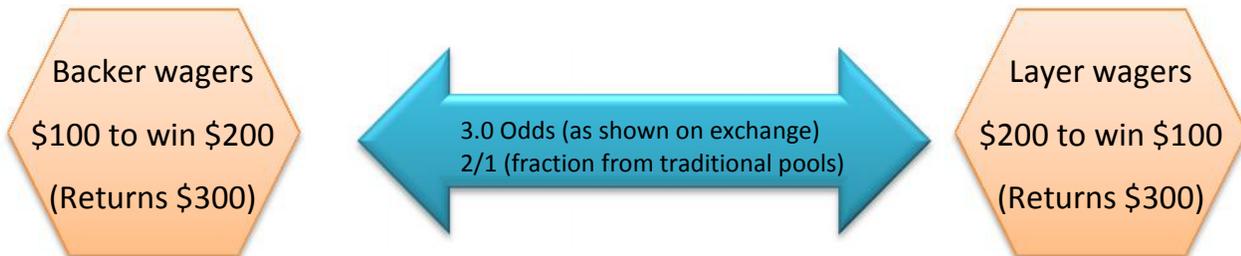
- Advance Deposit Wagering (ADW): is a form of wagering that allows bettors to place wagers via telephone, online, or other mobile device using funds they have deposited into an account. This allows gambling without having to be present at the location of the event. *491 Iowa Administrative Code 8.1(99D) defines “Advance deposit wagering” as a method of pari-mutuel wagering in which an individual may establish an account, deposit money into the account, and use the account balance to pay for pari-mutuel wagering.*
- Takeout: A percentage taken from pari-mutuel pools. Iowa code section 99D.11 defines the amount to be deducted from each pari-mutuel pool.

CONCEPTUAL DESIGN OF EXCHANGE WAGER

(Example to show an exchange is made for a horse to win 1st place)

HORSE WINS

\$200 is paid from the person who made the 'lay' wager to the person who made the 'back' wager



HORSE DOES NOT WIN

\$100 is paid from the person who made the 'back' wager to the person who made the 'lay' wager

Recent Federal Legislation. The Interstate Horseracing Act (IHA) was passed by Congress in 1978 and allowed interstate wagering on pari-mutuel races, simulcasting, in instances where pari-mutuel wagering is authorized in the states participating in the transaction (Iowa Racing and Gaming Commission, 2011). The original IHA was created before the inception of the internet; therefore it did not specifically address internet gambling. In 2000, the United States Congress amended the definition of off-track wager in the IHA to include a wager transmitted by other electronic media (Iowa Racing and Gaming Commission, 2011). A number of states have passed legislation authorizing internet pari-mutuel wagering and companies like TVG and Twinspires.com are currently accepting wagers via the internet. In addition, New Jersey passed legislation and rules regarding exchange wagering and states its regulations shall be conducted pursuant to, and in compliance with, the provisions of IHA (New Jersey Racing Commission, 2014).

In 1992, the Professional and Amateur Sports Protection Act (PASPA) was passed by Congress and makes it unlawful for a government entity to sponsor, operate, advertise, promote, license, or authorize by law or compact or for a person to sponsor, operate, advertise, promote, pursuant to the law or compact of a government entity, a lottery, sweepstakes, or other betting, gambling, or wagering scheme based, directly or indirectly, on one or more competitive games in which amateur or professional athletes participate, or are intended to participate, or on one or more performances of such athletes in such games (Rodefer, n.d.). PASPA contained a grandfather provision exempting the wagering schemes in place in Delaware, Montana, Nevada, and Oregon. PASPA allows for wagering on pari-mutuel animal racing or jai-alai games (Brennan, 2010).

The Unlawful Internet Gambling and Enforcement Act (UIGEA) was passed by Congress in 2006. UIGEA was part of the Safe Port Act and was the first federal law to specifically address internet gambling. The purpose of UIGEA was to prevent unlawful internet gambling by requiring payment systems like banks, credit card processors, and internet transaction processors such as PayPal and Net Teller to identify and prohibit restricted transactions (Iowa Racing and Gaming Commission, 2011). UIGEA does not make internet gambling itself illegal, instead it prohibits gambling businesses from knowingly accepting payments in connection with the participation of another person in a bet or wager that involves the use of the internet and is unlawful under any federal or state law.

Exchange wagering is person-to-person betting where participants bet against each other at odds established on their own. Technology is used by the exchange operator to matchup supply and demand. Exchange wagering occurs through an electronic platform and would most likely be offered through online wagering websites of licensed advance deposit wagering (ADW) companies in Iowa. A valid matched wager is formed when two or more persons are confirmed by the exchange wagering operator to have identically opposing (back and lay) wagers in a given market (New Jersey Racing Commission, 2014). Exchange wagering is authorized in California, New Jersey, Europe, and Australia. Even though authorized in California and New Jersey, neither state has yet to accept an exchange wager. New Jersey has promulgated rules and regulations and was expected to offer its first wager this year, while the Exchange Wagering Ad Hoc Committee of California's Horse Racing Board decided more discussion is needed, citing opposition from key figures in the horse racing industry (Smith, 2015).

Research Statement. The focus of the report is public welfare and regulation, along with addressing specific considerations required by Senate File 438. The report's objective is to

identify the opportunities and obstacles of exchange wagering as a form of race wagering so policymakers can make an informed public policy decision.

In order to properly answer the primary research statement, a series of sub-questions need to be studied in the report. What is the current state of exchange wagering? What is the current state of pari-mutuel wagering in Iowa? What is the potential revenue impact of authorizing exchange wagering for the licensees in Iowa? What measures and regulations are possible to protect consumers who may participate in regulated exchange wagering in Iowa?

Report Objective. The target audience of this report is the General Assembly of the State of Iowa. The report is being prepared pursuant to Senate File 438. The report is beneficial because it will identify the various policy and regulatory items that may be considered with respect to exchange wagering so the general assembly can make an informed public policy decision with respect to the authorization of exchange wagering in Iowa. The report will look into the jurisdictions that have already approved exchange wagering in an effort to evaluate what might be expected should exchange wagering be authorized. The report will discuss the current trends of pari-mutuel wagering in Iowa, as well as attempt to find information that may be helpful in understanding how or if revenue would be impacted for current ADW companies or facilities that offer pari-mutuel wagering. Lastly, the report will state the opportunities and obstacles of regulatory concepts available or needed to protect customers participating in regulated exchange wagering.

Scope/Limitations. This report will not make specific recommendations regarding the legalization of exchange wagering in Iowa, nor will the report express opinions on the likelihood of the legalization of exchange wagering in Iowa. In addition, this report will focus primarily on exchange wagering related to racing and will not study exchange wagering systems related to

sporting events that may be legal in other countries. The report will not express any opinions with respect to whether or not exchange wagering infringes on any current or proposed federal laws. It is important to note exchange wagering is relatively new and unfamiliar to the wagering industry and racing regulators in the United States. It is yet to begin in any racing jurisdiction in the United States, therefore it is possible for information or opinions expressed in this report related to the regulation of exchange wagering to develop or evolve quickly as more information becomes available. It is also important to note there was only one company IRGC staff was aware of to discuss potential regulatory concerns and solutions with respect to exchange wagering. Therefore, information in the report may be related more to experiences in other types of gaming or racing regulation and not necessarily that of exchange wagering regulation. Any revenue opinions or projections will be highly speculative and may not accurately depict future outcomes due to a lack of revenue information related to exchange wagering in the United States. In addition, projections may be impacted by assumptions that may vary due to the uncertainty of any language that might be included in proposed exchange wagering legislation.

Literature Review

There is considerable literature available on the topic of exchange wagering to conduct a thorough analysis for policymakers. The literature has been organized in this chapter into sub-topics that will best demonstrate the research questions that will assist in identifying the opportunities and obstacles of exchange wagering as a form of racing wager so policymakers can make an informed public policy decision for the citizens of Iowa. Many interviews and surveys were conducted with respect to the sub-topics and are summarized in the research methodology section of this report.

The various research questions were created so policymakers had an in-depth understanding of exchange wagering as required by Senate File 438. Specifically, it was necessary to research the current state of exchange wagering in an effort to understand any challenges or successes other jurisdictions in the United States or overseas have had. This information helped create a foundation because it identified real-world examples of stakeholders operating and regulating exchange wagering. It is also necessary to research the current state of pari-mutuel wagering in Iowa in an effort to understand who the current stakeholders are and how exchange wagering may impact the current wagering environment in Iowa. Another topic researched was the potential revenue impact exchange wagering might have if it were authorized in Iowa. Consumer protection measures and other regulations related to exchange wagering were researched in an effort to understand the best framework with which to base regulations in the event exchange wagering was authorized in Iowa. This research also identified consumer protection areas in the exchange wagering environment that would be difficult to regulate. Lastly, forms of exchange wagering offered by foreign jurisdictions unrelated to racing were researched and discussed briefly in the report.

Current State of Exchange Wagering. Literature was reviewed addressing the general concept of exchange wagering and the current state of exchange wagering in the United States. Articles have documented two jurisdictions where exchange wagering is allowed by law in the United States; New Jersey and California and the current status of their operations. While conducting research in this area, literature was obtained in order to summarize the current state of exchange wagering.

Andrew Gellatly, who writes for *GamblingCompliance*, reported the United States thoroughbred racing industry is attempting to reinvent itself with new wagering strategies and even online exchange betting, however disagreements between state regulatory authorities and the weight of history is making the task an uphill battle (2010). Gellatly reports according to the National Thoroughbred Racing Association CEO Alex Waldrop, the industry needs to do more to revive its fortunes. ADW does the most to fund the industry however, is being undercut by offshore providers who are able to beat the prices offered by licensed operators while using the broadcast signals sold to them by racetracks in the United States themselves. According to Mark Davies, Betfair's head of external affairs, at a time when racing in the United States is struggling to attract the Facebook generation to its most popular track meetings, such as Hollywood Park and Del Mar Thoroughbred Club, Davies concluded exchange betting captures the younger generation in a way the older product simply does not. Gellatly further reports Ed Martin, president of the Association of Racing Commissioners International, responded with his opinion that regulators are open to this idea but would have to interpret the exchange as essentially being a pari-mutuel pool of two people. Martin added integrity issues can be dealt with because you are dealing with accounts and due diligence on the individuals holding the accounts (Gellatly, 2010).

Scott Van Voorhis, with *Gambling Compliance*, reports racetracks in the United States are going to launch a major new push into online wagering, however gaining new fans and revenue over the internet may be challenging according to industry experts (2011). A consulting report released by The Jockey Club on the state of the embattled racing industry calls for new technology and innovative betting platforms to combat a slide in profits and interest. United States racetracks have already established a presence on the internet through ADW. Van Voorhis reports exchange wagering is popular in the United Kingdom and could find a place among racing fans in the United States. New Jersey and California have both approved exchange betting; however have not passed any rules for how the betting exchanges would operate (Van Voorhis, 2011).

According to an article in *Horse Racing Nation.com* exchange wagering is a trade on a betting exchange similar to the stock market (“What is so Great About Exchange Wagering”, 2012). There is a buyer and seller, which are known as a backer and layer. In exchange wagering, the backer is betting on a horse to win and the layer is betting on a horse to lose. A trade is made when a backer and layer match prices on the exchange and the price agreed upon. A person wagering may back and lay the same horse and potentially make a profit (“What is so Great About Exchange Wagering”, 2012). The article further illustrates how exchange wagering gives players the opportunity to take advantage of negative views on individual horses.

Exchange wagering is currently conducted in an online platform in Europe and Australia. One company providing an online betting exchange, Betfair, began a betting exchange in 2000. Betfair acquired TVG, a horse racing advanced wagering operator in the United States, in January 2009. According to Betfair, TVG is one of the largest online wagering businesses in the

United States and owns the TVG racing channel which is shown in approximately 35 million homes in the United States. TVG allows for betting via ADW online, by phone, with a web enabled mobile device and, where available, set-top remote control. (The Betfair Story, n.d.)

In a presentation entitled *December 2010, Exchange Wagering: A way to Grow Texas Horseracing*, Betfair explained exchange wagering allows individuals to bet against each other and set their own odds, which delivers consumers a fixed price at the time the bet is made. Betfair further explained the use of technology to match supply and demand with the operator bearing no risk. Betfair reported its typical customers are younger with higher disposable income and exchange wagering is appealing to the internet generation. Lastly, Betfair believes exchange wagering can benefit Texas horseracing by expanding the distribution of horseracing statewide through online technology and grow revenue to the industry and stakeholders (Betfair Presentation, 2010).

Frank Angst illustrates in an article appearing in *bloodhorse.com* Betfair's interest in offering exchange wagering on horse races in the United States that allow this form of wagering with California appearing to be furthest along in offering exchange wagering (2013). Angst further reports additional wagers other than racing can be made on an exchange wagering platform as Betfair offers exchange wagering on many sports, including horse racing (2013).

California has three dominant branches of legal gambling. These include, in order of market share, tribal casinos, commercial card rooms, and the lottery (Market Framework, 2015). They also authorize pari-mutuel and exchange wagering on horse racing, along with charitable gambling (Smith, 2015). The California Horse Racing Board regulates horse racing in their state and they currently have five racetracks, eight fairs, four authorized ADW sites, and

approximately 26 simulcast facilities where patrons can wager. Wagering is limited to horse and mule racing and was legalized in 1933 through a constitutional amendment. (California Constitution Art 4, Sec 19(b)) In 2010, California's state legislature sought to authorize exchange wagering, which was aimed at reinvigorating a slowing market in pari-mutuel wagering. With a younger generation more adept and interested in newer, more technologically savvy ways to gamble, exchange wagering was legalized with the hopes it would spur a renewed interest and generate more tax dollars (Smith, 2015).

With tribal gaming consuming much of the gaming market, California hoped the inclusion of a more consumer tech friendly way of wagering would increase tax revenue for their state. With the legalization of exchange wagering, legislators hoped to gain the interest of those persons who would be unlikely to visit one of the five racetrack facilities and instead, wager from their homes (Smith, 2015). In September of 2010, both the California Assembly and the Senate approved legislation for exchange wagering which would "allow gamblers to use the Internet to set their own odds on horse races, bet against each other and place wagers while a race is in progress" (Batt, 2010b). With this approval, it was stipulated the California Horse Racing Board would prepare regulations and rules for governing pari-mutuel exchange wagering. These rules were to be completed by May 2012. This delay was implemented to give both the regulators, the horse racing industry, and other interested parties time to research possible issues that would arise in conjunction with this new legislation and for education on behalf of the regulators who would be developing the regulatory statutes. Preliminary discussions also included the addition of a sunset provision that would allow the legislation to either be retracted or expanded in a shorter term of possibly three to five years. Many opponents immediately posed questions about what the ramifications of this bill might prove for the horse racing industry.

Opponents want to know how the law would be applied so it would be in compliance with current state and federal gaming laws, how consumers would be protected, and additionally, which consumers and where they would be allowed to participate (Batt, 2010b).

After months of discussion and negotiations, the directors of the Thoroughbred Owners of California (TOC) reported in May of 2012 that the start date for exchange wagering would be delayed a minimum of twelve months because of concerns in the horse racing industry (Townend 2012b). They had continued concerns about the ethical implications of allowing wagers to be placed for horses for a loss versus a win, and trainers have even more concerns about what future legal issues this could bring for them if a horse continues to lose, yet makes monies for gamblers. Opponents fear that when wagers are allowed to be made against a horse, it will become much easier for a race to be fixed. Betfair had assumed negotiations were moving ahead in a positive manner and had anticipated exchange wagering to begin by the start of summer 2012, though there were still major concerns they would end up collecting a majority share of the purses available and the integrity of the race could be compromised. Betfair countered with confidence in their technology and confidence in preventing corruption, citing their agreement with the International Olympic Committee for an information sharing agreement (Batt, 2012). The TOC stated it needed additional time for research and development and to try to reach a compromise between all parties. Chairman of the TOC, Mike Pegram, stated the delay in (action) “will give us additional time to study this betting alternative and consider if it is in the best interests of the industry in our state” (Townend, 2012b).

In November 2012, the California Horse Racing Board moved to adopt regulatory rules for exchange wagering, but still faced obstacles which included review and approval from other

state agencies and issues with implementation of these rules (Krafcik, 2012). When given final approval, exchange wagering could begin with Quarter Horse, Standardbred and Thoroughbred racing. In anticipation of approval, two companies submitted applications and applied for provisional licenses to be granted, especially since the initial licensing fee had decreased from a \$1.4 million to \$265,000. The licensing fees would be paid directly to the California Horse Racing Board to purchase and install hardware and software. The fees would also help pay for training regulators tied directly to exchange wagering. While reluctant to proceed with granting the provisional license, some benefits would apply to the regulators so they could have more funds for training and research prior to implementation of the rules (Krafcik, 2012).

In August 2013, approval was granted by the California Office of Administrative Law for the rules proposed by the California Horse Racing Board (CHRB) and exchange wagering was approved (Marten, 2013). These rules highlight several areas including licensing, how wagers would be made and what to do with exceptions, auditing and consumer accounts. They also stated while the current regulatory framework is in place, exchange wagering cannot begin until agreements are in place between horsemen, racetracks, exchange wagering companies and then approval by the CHRB (Marten, 2013). As of this date, negotiations are ongoing and exchange wagering is not being conducted in California.

Tony Batt reports New Jersey will be the first state to offer exchange betting on horse racing after New Jersey Governor Chris Christie signed a bill to authorize the new wagering model in 2011 (2011). The New Jersey exchange betting is aimed at attracting younger, computer savvy gamblers. Batt reports exchange wagering has been pioneered by London based Betfair and popular in Europe and Australia and proponents in the United States believe it will

boost horse racing in America. Batt further reports according to Barbara Demarco, Vice President of Porzio Governmental Affairs and a lobbyist for the New Jersey horse racing industry, the exchange wagering bill will provide more ways for gamblers to bet on horse races. She said exchange wagering is not, in and of itself, enough to save the New Jersey horse racing industry, and other measures such as installing slot machines at tracks should be considered. Batt reports there are complaints that exchange wagering will reduce the size of purses and the result will be less money for track employees. Demarco said exchange wagering is likely to result in a larger betting pool that will offset, if not exceed, any purse reductions (Batt, 2011).

Batt also reports exchange wagering in the United States faces an uncertain future after a California regulatory committee declined to make a recommendation on how to proceed with the new betting method (2012). California tracks and pari-mutuel operators were scheduled to offer exchange betting beginning in May 2012 according to a law passed by the California state legislature. Citing opposition from the horse racing industry, the *Exchange Wagering Ad Hoc Committee of California's Horse Racing Board*, on February 9, 2012 decided more discussion was needed (Batt, 2012).

Batt further states Betfair was optimistic exchange wagering would begin within months in the United States and exchange wagering is aimed at reviving interest in horse racing by offering gamblers a more innovative way to bet that appeals to a younger generation more comfortable with computers (2012). Batt reports The Stronach Group, which owns Santa Anita Park and Golden Gate Fields in California, has threatened a lawsuit against the California Horse Racing Board if it approves exchange wagering for its tracks. According to Batt, critics argue exchange wagering will allow Betfair and other exchange betting operators to take the "lion's

share” of purses away from horsemen, jockeys, and other track personnel. Critics also claim exchange wagering makes it easier to fix a race as it effectively allows gamblers to bet on a horse to lose. As a result, exchange wagering in California is on hold (Batt, 2012).

According to Jessica Martini, with *ThoroughbredDailyNews.com*, exchange wagering was to make its debut in the United States when live racing returns to Monmouth Park in May 2014 after the track and Betfair reached a five year agreement (2014). Martini states the New Jersey State Legislature approved exchange wagering which allows fans to wager against one another, set their own odds, and wager during races in 2011. Monmouth Park could become the first track in the United States to offer exchange wagering. Martini reports that according to Dennis Drazin, advisor to the track’s operator, Darby Development, TVG/Betfair has been an integral part of Monmouth Park’s success due to the live TV at the racetrack and the account wagering. Drazin further stated the New Jersey Racing Commission has completed its regulatory scheme which must now be sent to their state attorney general’s office for review (Martini, 2014).

Matt Hegarty, with *Daily Racing Form*, reports the New Jersey horsemen and Betfair have a tentative deal for exchange wagering at its races beginning in May 2014 at Monmouth Park (2014). According to Hegarty, Monmouth could become the first Thoroughbred track in the United States to allow exchange wagering, a controversial type of betting pioneered by Betfair that allows customers to set their own odds on horses and take wagers from other bettors through an online platform. According to Hegarty, supporters contend it could draw new money to racing and critics have voiced concerns of allegations of race fixing. Hegarty said Betfair expanded to a number of jurisdictions and the 2009 purchase of TVG was a way to plant stakes

in the United States. Hegarty also reports critics have stated exchange wagering allows players to bet on a horse to lose and provides incentives for trainers or jockeys to hold horses in races, however according to Betfair, they closely monitor its service and alert regulatory authorities to suspicious bets (2014).

Tracy Gantz, with Bloodhorse.com writes that California based trainer and attorney Darrell Vienna stated exchange wagering “is basically stalled in California unless and until there is a business model that satisfies the needs of the horseman, that they are properly remunerated”(2014). Issues raised include cannibalization of existing wagering and whether exchange wagering would compromise racing integrity. Gantz further reports Vienna stated it’s easier to manipulate a race to lose than to win. The potential for illicit or nefarious behavior and cheating is exponentially greater once you allow a consumer to bet on a horse to lose (Gantz, 2014).

Chris Brand (British Horseracing Authority) stated it should be vital the licensees set up appropriately strict rules to help protect the integrity of the game, however also states that “people will try and cheat using exchanges” (Paulick, 2011b). He then stated, “They tried to cheat in Britain before the advent of exchanges here”, “the risk rises accordingly” with the increased margin for profit and “it would be naïve to think it won’t be the same in the US” (Paulick, 2011b). There is also the issue of combatting the public’s negative view about wagering while a race is already in progress (Mitchell, 2011). This could impact how the public perceives the horse racing industry and in effect, have a negative impact on wagering. Carlo Zuccoli, former consultant for the European Pari-Mutuel Association (EPMA), stated corruption has increased in the United Kingdom since the advent of exchange wagering. One such incident

had six jockeys in the United Kingdom allegedly being paid £5,000 per race to lose (Mitchell, 2011).

In an article written by James Kilsby, with *GamblingCompliance*, a reference was made to the British interest in America's gaming market on the rise, with a number of companies hoping their expertise in online gambling, sports betting, and racing will translate into success (2014). Kilsby reports many of Britain's largest and best known gambling companies have inked partnerships with American operators or acquired firms in the United States. British betting companies Betfair and Stan James have acquired businesses in the United States offering online pari-mutuel wagers on horse races. Betfair, through TVG, believes it is now challenging Kentucky's famed Churchill Downs as America's number one online wagering operator and it has been pushing to bring its signature exchange betting model to the United States starting either in New Jersey or California (Kilsby, 2014).

Kevin Cochran, with *GamblingCompliance*, reports the New Jersey market consists of four racetracks with pari-mutuel wagering, horse racing, and off-track betting (2015a). Although exchange wagering on horse racing has been authorized, it has yet to be implemented (Cochran, 2015a). Cochran summarizes in his January 2015 State of New Jersey report for Gambling Compliance that the racing industry continues to face challenges. There are four racetracks in New Jersey: Monmouth Park, the Meadowlands, Freehold Raceway, and the Atlantic City Race Course and four off-track betting locations in New Jersey – Bayonne, Woodbridge, Vineland and Toms River. Cochran reports that there was a pilot program allowing for off-track wagering on horse racing at bars and restaurants, signed by Governor Christie in January 2012. ADW is legal

in New Jersey and residents may wager over the phone or the computer on horse races, however only a resident of New Jersey who is at least 18 years old can open an account for ADW (2015a).

Cochran reports in 2011 the Exchange Wagering Act was passed authorizing exchange wagering on results of in-state and out-of-state horse races (2015a). Exchange wagering is to only be conducted in accordance with a valid exchange wagering license issued by the New Jersey Racing Commission. Options to place exchange wagers include: in person, by telephone, or by communication through electronic media from residents of New Jersey by a licensed exchange wager operator. Exchange wager revenues are intended to subsidize racing purses (Cochran, 2015a).

Tom LaMarra, independent writer for bloodhorse.com reports the Stronach Group stated racinos are not the answer for horse racing in the long run (2015). According to LaMarra, Mike Rogers said the Stronach Group isn't necessarily against exchange wagering (2015). They opposed efforts to establish it in California, where it owns and operates Santa Anita Park and Golden Gate Fields, because of issues over control. LaMarra reports exchange betting has been pushed by Betfair, owner of TVG, a California based ADW service and racing network. "We don't need a third party taking bets." Rogers said. "If we offer exchange wagering, it should be us offering it – the tracks and the horsemen. It's important we control that not someone else." (Lamarra, 2015).

New Jersey Regulations. Proposed New Jersey rules and regulations were reviewed and summarized which may help to understand their approach to exchange wagering. In June 2014, the New Jersey Racing Commission issued a proposal to establish rules for the implementation of exchange wagering which is authorized by the Exchange Wagering Act of 2011. The New

Jersey Racing Commission has the authority to prescribe rules, regulations, and conditions under which exchange wagering may be conducted in New Jersey. To begin, the exchange is to be conducted by an exchange wagering licensee subject to a license issued to the New Jersey Sports and Exposition Authority by the New Jersey Racing Commission, known as the Authority. The exchange is known as the system, operated by the exchange wagering licensee, through which it maintains one or more markets in which residents of New Jersey, 18 years or older, who have established an exchange wagering account, may wager on a selected outcome on horse races conducted within and outside the state of New Jersey (New Jersey Racing Commission, 2014).

New Jersey's proposed rules are categorized into subchapters addressing the rules and regulations of exchange wagering.

- Subchapter 1 provides for general provisions and definitions of exchange wagering in New Jersey. The rules are applicable to exchange wagering and persons licensed in New Jersey by the New Jersey Racing Commission. Rules are also applicable to every patron and exchange wagering account holder (New Jersey Racing Commission, 2014).
- Subchapter 2 is the exchange wagering initial license application process for the Authority, known as the New Jersey Sports and Exposition Authority and the subsequent terms and conditions of issuing a license to the Authority by the New Jersey Racing Commission. According to subchapter 2, the initial application guidelines for the applicant include internal controls, location of the hardware and software, information concerning the exchange wagering platform and whether it is intended to be stand-alone or integrated with a totalizator machine. The Authority is also required to attach to its application the internal controls and procedures to operate and manage the exchange

wagering system, procedures involving wagers, integrity and recordkeeping. Further, the Authority is required to provide reliability and sufficient safeguards to maintain the integrity of the horse racing industry in New Jersey. The Authority must explain whether it intends to conduct or operate the exchange itself or enter into a management agreement with an exchange management agent (New Jersey Racing Commission, 2014).

- Subchapter 3 addresses the transfer or assignment of the exchange wagering license to a successor. There is also an in-state requirement for system components and the requirement the exchange wagering licensee, and any approved management or services agent are required to maintain an in-state office. Subchapter 3 also provides for unrestricted access by the New Jersey Racing Commission, regulatory costs and revenue distribution of the exchange wagering system. Once the exchange wagering system becomes operational, the licensee is required to complete an audit regarding exchange revenues (New Jersey Racing Commission, 2014).
- Subchapter 4 addresses standards for the establishment and maintenance of exchange wagering accounts including rules concerning how eligible New Jersey residents may establish an exchange wagering account, restrictions on exchange wagering wagers, closing an exchange wagering account, payment of accounts, patron disputes and complaint filing. The rules also provide exchange wagering accounts must be established through the exchange wagering licensee. Accounts may be established by residents of New Jersey who are at least 18 years old. The exchange wagering licensee also makes the determination to accept or reject an application for an account. The licensee is also required to verify the identification, residence, and age of the account holder. The licensee is required to maintain complete records of every deposit, withdrawal, wager,

and winning payoff for every exchange wager. Subchapter 4 also provides exchange wagering may be placed in person, telephone, computer or other electronic media approved by the New Jersey Racing Commission. Accounts may be funded by cash deposit, credit or debit card consistent with the internal controls of the exchange wagering licensee. Check, money order, wire or electronic transfer of funds to the account is also permitted. The exchange wagering licensee may not directly extend credit to an account holder (New Jersey Racing Commission, 2014).

- Subchapter 5 addresses rules and procedures for wagering through the system. Included in subchapter 5 are which market types are permissible, technological malfunctions of the exchange wagering system, market suspension and market voiding in relation to a horse race, and placement of corrective wagers and finalization of wagers. The rules also provide for cancellation of unmatched wagers, non-starters and declared or scratched entries, wagering pools, hardware or software changes to the system and race related information provided to account holders (New Jersey Racing Commission, 2014).
- Subchapter 6 addresses rules concerning licensing requirements and responsibilities for persons and entities involved in or providing services in connection with the exchange wagering system, penalties that may be imposed and procedures for hearings and appeals (New Jersey Racing Commission, 2014).

Legislative History and Current State of Pari-mutuel Wagering in Iowa. Literature was reviewed addressing the current state of pari-mutuel wagering in Iowa. Information was obtained through research of published articles and from documentation from IRGC staff. While

conducting research in this area, literature was obtained in order to summarize the current state of pari-mutuel wagering in Iowa.

In May of 1983, the Iowa Legislature passed the Pari-Mutuel Wagering Act allowing qualified organizations to apply for a license to conduct pari-mutuel wagering on horse and dog racing. The Governor signed the bill and appointed the first Racing Commission (IRGC) on July 1, 1983, and IRGC issued four licenses in locations throughout the state for three year terms. Legislation was put into place in 1989 to allow pari-mutuel wagering on simulcast races received by a licensed pari-mutuel facility conducting a minimum number of live performances. Simulcasting is the telecasting of live audio and visual signals of pari-mutuel races received from an authorized racing facility for the purpose of pari-mutuel wagering. In May of 1992, legislation was enacted removing the live performance requirement for simulcast wagering at pari-mutuel facilities. In 1994, that legislation was amended requiring at least sixty performances of nine live races each day of the season in order for simulcasting to occur primarily as a condition to have slot machines (Chronology, n.d.).

Prairie Meadows Racetrack and Casino filed for Chapter 11 Bankruptcy on November 27, 1991, with the Final Order issued in May 17, 1993 concluding their bankruptcy (Chronology, n.d.). Unfortunately, the availability of additional gambling opportunities through other casinos most likely contributed to the decline in gambling at the facility, which was seen as a national trend. With the licensing of additional gambling facilities, along with off-track betting and lotteries, this trend was seen nationwide and there has been a steady decline in the number of races and live handle each year. At this time, the idea of racinos, pari-mutuel racetracks with slot machines on the premises, was introduced and designed to attract more gamblers who also might

participate in pari-mutuel wagering (Loss, 2014). This new scenario was developed to pay back the public financing to the community and could also supplement thousands of dollars to local charities and community projects. Additionally, if the gaming revenue could supplement racing purses, this would contribute to Iowa's overall agricultural economy (Miller, 2012). With changes in legislation, Iowa issued licenses for three racinos within their state in 1995 (Chronology, n.d.).

In June 2002, the Iowa Supreme Court ruled it was unconstitutional for the State, for tax purposes, to treat slot machines at racetrack enclosures differently than riverboat slot machines. This decision resulted in lowering the tax paid by the racetrack enclosures to 20 percent instead of the graduated tax structure previously determined. This decision was appealed by the State to the United States Supreme Court. In June 2003, the Supreme Court ruled the state's differential tax rate did not violate the Equal Protection Clause of the United States Constitution. The Iowa Supreme Court's judgment to the contrary was reversed, and the case was remanded for further proceedings not inconsistent with that opinion. However, The Iowa Supreme court determined that the differential tax rate violated the Iowa Constitution and reinstated its previous decision (Chronology, n.d.).

In June of 2010, Prairie Meadows commissioned Eric Jackson to review their racing program and related marketing. After a thorough review of the staff, operations, and management, Jackson concluded Prairie Meadows had the potential to be one of the premier tracks in the United States. With additional marketing, increased media coverage and better labor relations, the racing share of overall revenue could grow exponentially and have a significant economic impact in Iowa (Jackson, 2010).

The Legislature voted in 2011 to allow ADW at Prairie Meadows Racetrack and Casino. An outside company manages these funds and sets up accounts for gamblers to deposit monies for wagering. Wagers are typically made via the telephone or internet for betting on pari-mutuel racing. This measure only applied to Prairie Meadows Racetrack and Casino and patrons are required to set up the account in person prior to being able to wager through the system (Paulick, 2011a). Wagering was set to begin in early 2012. During this time the purse structure was amended with divisions of the purse structure as 76 percent designated for Thoroughbred racing, 15.25 percent for Quarter Horse racing, and 8.75 percent for Standardbred racing (Todd, 2012).

A bill was passed and signed on May 30, 2015 to end greyhound racing at the two tracks in Iowa. This allowed final races at the Bluffs Run track in Council Bluffs to be concluded by the end of 2015 (Nelson, 2014). Mystique Casino held final races at the Dubuque track in 2014. In November 2014, IRGC approved a license for the Iowa Greyhound Association to conduct pari-mutuel wagering on live races at the Dubuque track (Gazette Des Moines Bureau, 2014). Greyhound racing at both tracks has been conducted as approved and scheduled in 2015.

As reported in the 2014 IRGC Annual Report, combined live racing and simulcast handle for Prairie Meadows was slightly down from 2013, though wagers made through ADW increased from the previous year (2015). The ADW handle on Prairie Meadows live racing increased from \$129,647 to \$137,384 and the ADW handle on non-Prairie Meadows races increased from \$1.21 million to \$1.58 million. This increase could signify a trend in the wagering market that patrons might gamble more if they can do it from the ease of their homes or with mobile devices (2014 Annual Report, 2015).

Potential Revenue Impact of Authorizing Exchange Wagering for Licensees in Iowa.

Literature was reviewed addressing the potential revenue impact for licensees if exchange wagering is authorized in Iowa. Information was obtained through research of published articles. Limited resources were available for a comparison as currently there is no legal exchange wagering within the United States. While conducting research in this area, additional literature was obtained from jurisdictions outside the United States to aid our research.

Ray Paulick published an editorial in 2011 supporting the introduction of exchange wagering in the United States by reviewing exchange wagering conducted by Betfair in Europe (Paulick, 2011b). Currently in Britain, exchange wagering is legal and the company Betfair is the primary vendor supporting the application. Betfair states the pari-mutuel handle has increased by 67 percent since the onset of exchange wagering, and the fear of cannibalization is false. They also state the new medium of wagering is actually attracting much younger gamblers, those that might not participate in traditional pari-mutuel wagering (Paulick, 2011b). Supporters of exchange wagering hope the horse racing industry will increase enough to support themselves solely and not have to rely on casino subsidies. They are also hoping the new money will increase purses and build higher, larger fields for races (Batt, 2010a). John Hindman, General Counsel for TVG, subsidiary of Betfair, states “betting exchanges don’t support exotic wagering, which makes up 70% of today’s wagering in the US” and that “75% of current wagering is not done on the computer, whereas all of exchange wagering is on the computer” (Gantz, 2014).

Opponents of exchange wagering have a much different view of division of monies where exchange wagering is concerned. It has been stated in the United Kingdom that exchange

wagering takes monies away from legal bookkeepers and does not return enough money for purses or the horse racing industry. Carlo Zuccoli stated, “In England, they are struggling for prize money. The levy has gone down 40%. Betfair is drawing a huge amount of money from the tote and the bookmakers” (Mitchell, 2011). A big issue that has yet to be resolved is how the takeout will be allocated in the United States. Chris Brand, the acting chief executive for the British Horseracing Authority, strongly opposes the numbers stated by the supporters (Paulick, 2011b). He claims the key data has been manipulated and is not being compared in a like manner, producing unrealistic and incorrect numbers. The United Kingdom has since changed some of its betting calculations, however Betfair has since moved offshore and is now not subject to a tax levy. Brand says the United States is in better shape since it is in the position to impose tighter controls and provide protection to the horse racing industry, insuring higher purses and fair distribution of funds (Paulick, 2011b).

Martini writes Betfair has been criticized for returning minimal portion of wagers to European racetracks and horsemen, however, reports Drazin is happy with Betfair’s agreement with Monmouth (2014). Addressing concerns exchange wagering may take money away from traditional wagering pools; Drazin explained there are three components of the product. “One is the typical scenario we’re familiar with at racetracks where you bet on the win, place, show pools and bet on your exotics. The way that it breaks out historically in New Jersey; about 30% of the money is in the win place show pool, 70% in the exotics. Exchange wagering is not offered in the exotics, it is only in the 30% category. So we think the 70% category will stay consistent or grow, we think that the area of potentially shifting money from live racing the 30% some of it could shift to exchange wagering, so you’re hoping to increase your volume there to offset any money that moves across the board.” (Martini, 2014). Drazin thinks exchange

wagering, particularly the in-play wagering option, will attract a new group of fans to horse racing. “There is no in-race wagering in New Jersey so that is all new money and exchange wagering is geared for a different demographic. This isn’t something that the typical person that is at the track is going to be betting into in-race wagering because it moves too quickly. You’re going to be doing these mostly on computers or on machines that we have at the track or from home or from your office or smart phone and I think it will increase the population of people who want to wager and the track people who may currently play the stock market.” (Martini, 2014).

Brett Hale, vice president of corporate and government relations for Churchill Downs, has serious concerns about exchange wagering, especially using Betfair. He states, “...we’re concerned that the projected growth in wagering is unrealistic and exchange wagering would actually leave less money in the system for those responsible for putting on the show, such as horse owners, breeders and racetracks” (Batt, 2010a). The horse racing industry asked how revenues would be shared between track owners, breeders and horse owners and would it actually be better than the current pari-mutuel industry in California. Because of the addition of an outside party, opponents feared it would greatly reduce the amount of monies available to both the horsemen and track employees, along with spoiling the long tradition of horse racing in California. They also project once exchange betting is in place, it would make the percentage of the purse going to employees of the race to plummet from 16 percent to one percent. Advocates claim the addition of exchange wagering could add upwards of about \$30 million into the industry (Batt, 2010a). The horse racing industry in the United States has been reluctant to broker deals with Betfair to start exchange wagering (which is needed in California to proceed) stating they return less than one percent of each wager back to the horsemen/track owners versus

the approximate 20 percent they now receive through the traditional pari-mutuel system (Hegarty, 2014).

Dennis Drazin would not provide details of Monmouth's agreement with Betfair, but he said the pact calls for the track and its horsemen to receive a percentage higher than in Britain (Hegarty, 2014). Drazin also said he does have concerns exchange wagering will significantly cannibalize existing pari-mutuel handle on the track's races, in large part because betting is limited to straight wagers and only New Jersey residents will be allowed to use the service (Hegarty, 2014).

Areas of Consumer Protection. Literature was reviewed addressing general areas of consumer protection that have been or could be considered for regulation of exchange wagering. A considerable amount of articles have documented concerns about money laundering, insider trading, and outcome manipulation.

Andrew Gellatly reported that unsuccessful money laundering attempts by terrorists were made on the Betfair website (2007). This was supported in an article by unnamed law enforcement officials who suggest a number of sites in the United Kingdom including Sportingbet.com, ParadisePoker.com, and eurobet.com were targeted (Gellatly, 2007). A later article by Andrew Gellatly showed Victorian police and government representatives were concerned about money laundering and fraudulent activities involving industry representatives (2008). Australian racing stakeholders had specifically viewed betting exchanges to be an unnecessary risk for the industry, though improved communication between law enforcement and the industry and strengthening of investigative powers were recommended (Gellatly, 2008). Because exchange wagering allows wagers for horses to lose, critics are concerned jockeys and

trainers will have incentives to hold horses back. Other concerns include allowing bettors to set their own odds and wager past post times (Hegerty, 2014).

Bloodhorse.com illustrated some of these concerns as well. During a January 2012 session of the Horsemen's Benevolent and Protective Association winter convention in Pasadena, California, a panel discussed exchange wagering (Gantz, 2014). California based trainer and attorney Darrell Vienna argued it is easier to manipulate a race to lose than to win. He added the opportunity for cheating is exponentially greater when you allow a consumer to bet on a horse to lose (Gantz, 2014). David Altaner reported that British Horseracing Authority Director of Integrity Services Paul Scotney claims education is key (2012). What most people call 'match fixing' is rare and actually insider trading. Scotney added misuse of information happens in other sports and may not always be intentional, though sanctions for insiders who divulge inside information are necessary (Altaner, 2012). An example of insider trading was detailed in a Gambling Compliance article entitled, "Horse Racing Bosses, Betfair disagree on Ban". Horse owner Harry Findlay was banned from running his horses and from visiting racecourses for six months after wagering on his horse, making separate lay and backing wagers (Longley, 2010). British Horse Racing Authority ruled this resulted in a net win for more than if he would have just bet the horse to win and also may have been an attempt to move the market (Longley, 2010).

Two separate incidents of race outcome manipulation were reviewed from 2013. The first case in January from the United Kingdom showed how jockey Andrew Heffernan was disqualified for 15 years for conspiracy, riding horses to lose, taking a bribe, and passing insider information. Eight others were barred from racecourses for a total of 70 years for benefiting from

inside information (Townend, 2013a). The other case from May showed how the British Horseracing Authority banned jockey Eddie Ahern for 10 years for insider trading activities as well as holding a horse (Townend, 2013b). It seems important to note increased capability by the British Racing Authority as they successfully investigated and proved these cases of conspiracy and corruption. It is not clear if these examples are indicative of racing in general, exchange wagering, or of a particular market. Research did show, however, that industry forces recognize threats of this nature and have taken steps toward protecting integrity (Townend, 2013b).

As early as 2007, Betfair employed a four-person anti-money laundering team who worked with law enforcement during and after the investigation as necessary (Gellatly, 2007). This type of cooperation seems to have been demonstrated by other stakeholders as well. The European Sports Security Association, an operator funded monitoring organization, reported eight suspicious alerts in 2011 and 61 irregular and suspicious betting patterns (Altaner, 2012). Monitoring of suspicious transactions has been one protection measure, although the Victorian Police recommended licensing of commission agents to deter a culture of intimidation and interaction with individuals attempting to manipulate the system (Gellatly, 2008).

Research was limited in terms of protection measures for systems data and funds security. One incident of the industry dealing with technical issues was found in Gibraltar. Betfair agreed to payout after a technical glitch voided bets when one gambler was allowed to make wagers not supported by his account balance. Cooperation with the Gibraltar Gaming Commission resulted in Betfair paying wagers made up to the point when the error was made, thereby satisfying those customers. Bots were allowed by Betfair to place automated trades in this case impacting payout

odds with some wagers accepted after race completion. Betfair fixed the related technical issues (Townend, 2012a).

Since this issue, a model for exchange wagering regulation supplied by TVG included structure for exchange wagering accounts, deposits, credits and debits to those accounts, withdrawals, suspending or closing accounts, unclaimed funds, handling of wagers, types of wagers and markets, revenues, distribution of revenues, and prohibited wagers (TVG, 2015). Both the TVG and Betfair websites address identity, problem gambling, and minors as well. The TVG website provides an overview of their AWARE program (Always Wager REsponsibly). This includes minimum age requirements, account access, a cooling-off period, self-exclusion, and other responsible gambling resources (TheAwareProgram, 2015). The Betfair website provides an overview of minor protection, self-exclusion, setting limits, time-outs, and session timers (Protecting Minors, 2015).

Sports and Fantasy Exchanges. Literature was reviewed exploring the impact of sports and fantasy games. European wagering on sporting events are regulated as they are all seen as gambling and not games of skill as interpreted in the United States (Macadam & Macadam, 2015). *The Betfair* website, for example, shows many gambling opportunities to wager on game outcomes for golf, tennis, football, and other sporting events. Fantasy sports or interests in individual player statistics are not allowed. For wagering on fantasy sports to become attractive in Europe, the opportunities will need to be faster paced than what is offered in the United States. Any company seeking to offer these products would have to be licensed and activities regulated. Given this reality, companies like FanDuel and DraftKings would find this difficult particularly

since they are motivated to maintain non-gambling status in the United States (Macadam & Macadam 2015).

In the United States, the status of fantasy sports has evolved since the Unlawful Internet Gambling Enforcement Act (UIGEA) passed in 2006. Research showed many states have interpreted this act to allow fantasy sporting games to be offered and played over the internet. A *Gambling Compliance* article classified states into three categories: states where fantasy sports are not offered by most operators, states where fantasy sports are not offered by some operators, and states where fantasy sports have been deemed legal by statute or regulation. Iowa is listed under “not offered by most operators” (Cochran, 2015b). In Nevada, on October 15, 2015 the Nevada Gaming Control Board issued an order declaring that pay to play daily fantasy sports constitutes gambling under Nevada law. As such, it is illegal to operate in Nevada without the appropriate license. The order further stated that all unlicensed activities must cease and desist from the date of the notice until such time as either Nevada law is changed or until such entities file for and obtain the requisite licenses. Burnett, A. (2015, October). The approach taken in New Jersey illustrates another strategy. In 2015, Monmouth Park Racetrack announced a partnership with Fantasy Sports Network to develop and operate fantasy games (Mazur, 2015).

Research has also found professional sports leagues have shown interest in fantasy sports games. In 2014, Major League Baseball (MLB) announced a partnership with DraftKings and MLB commissioner Rob Manfred commented baseball tries to “maintain a pretty clear line between what we see as fantasy products on the one hand and what we see as gambling on the other” (Batt, 2015a). According to Batt in an article in *Gambling Compliance*, DraftKings also has agreements with the National Basketball Association (NBA), National Football League

(NFL), National Hockey League, Ultimate Fighting Championships, and World Series of Poker (2015a). Market competitor FanDuel reportedly has established partnerships with NFL and NBA teams and the NBA has an equity stake in the venture (Batt, 2015b). Professional sports leagues have been partnering with or buying equity in both DraftKings and FanDuel and will soon dominate the fantasy sports market (Batt, 2015b).

The size of the unregulated sports gambling market cannot be determined, but is estimated to be \$500 billion (Batt, 2015b). DraftKings chief executive Jason Robins estimated daily fantasy sports wagering would increase to \$1 billion in 2014. Robins added more than 80 percent of the profits go to five percent of the profitable players (Altaner, 2015). A small percentage of fantasy players use algorithms and sports analytics to hold an advantage over casual players. Inside information demand may lead to fraudulent activity, controversy, and legal issues which may hurt both fantasy sports and sports betting (Batt, 2015b). Since individual player statistics may be easier to manipulate, this may increase the chance of insider trading or match fixing according to Daniel Wallach of Becker & Poliakoff, a Florida law firm (Altaner, 2015).

Research Methodology

Research Approach. The purpose of this research is to identify the pros and cons of exchange wagering as a form of racing wager so policy makers can make an informed public policy decision. In order to properly address this objective, information was gathered on the current state of exchange wagering, the current state of pari-mutuel wagering in the State of Iowa, the potential revenue impact of authorizing exchange wagering, and various consumer protection areas related to exchange wagering. The approach for this research is similar to a feasibility study. The approach aims to objectively evaluate exchange wagering for Iowa and determine the strengths and weaknesses of the many facets of exchange wagering in order to ascertain the prospect for legalizing and effectively regulating exchange wagering in Iowa.

The data for this approach was collected from existing scholarly articles and studies, existing rules and regulations from other jurisdictions where exchange wagering is legal, existing racing trade publications, surveying pari-mutuel customers via on-track or through the racetrack or horsemen organization websites, interviewing or discussing with parties including: Iowa Code 99D licensees, potential exchange wagering operators, horsemen organizations, other regulators where exchange wagering is being considered, and other parties interested in exchange wagering for Iowa. Senate File 438 was assessed to determine what specific areas of exchange wagering should be researched for this report. After this assessment, areas were identified and interviews and discussions were conducted to appropriately and judiciously report on the possible authorization of exchange wagering as a form of pari-mutuel wagering in Iowa.

It is anticipated information will continue to be gathered throughout the writing of this report due to the evolution of exchange wagering in New Jersey and possibly California,

therefore this report will make every effort to include information available up to the December 1, 2015, deadline.

Data Collected. Data was collected from scholarly articles and published studies researching the current state of exchange wagering, potential revenue impact of authorizing exchange wagering, and on the types of regulations that may be possible to protect consumers who may participate in exchange wagering. Information from interviews assisted in learning various stakeholder opinions on the current state of exchange wagering, the current state of pari-mutuel wagering in Iowa, as well as the potential revenue impact of authorizing exchange wagering. Published exchange wagering rules and regulations in New Jersey and California played a big role in determining the possible protections available for patrons. Historical information on the racing industry in Iowa and pari-mutuel wagering information gathered from the IRGC website were utilized to determine the current state of pari-mutuel wagering in Iowa and the potential revenue impact from exchange wagering. A survey was conducted of pari-mutuel players to research the current appetite for exchange wagering in Iowa.

Additional information pertaining to internet gambling, fantasy sports, and exchange wagering on other activities such as sports was discovered. Information and opinions were also observed in relation to ADW without an exchange wagering platform. Information and data in these areas were not collected as they did not directly relate to IRGC's task at hand.

Data Collection Procedures. A portion of the data for this research was collected via survey. The survey was created by IRGC staff to help gauge the attitude towards exchange wagering by sampling Iowans with an interest in pari-mutuel wagering. The survey was made available to participants in the racing industry in Iowa including the Iowa Horseman's Benevolent and Protection Association (IHBPA), Prairie Meadows Racetrack, Bluffs Run

Greyhound Park, and Iowa Greyhound Park. Therefore, survey results will be a combination of both the general public and racing industry.

The survey was made available in two ways. The survey was listed on the website surveygizmo.com. IRGC staff requested that management at the three racetracks in Iowa as well as the IHBPA provide a link on their website to the survey. Additionally, paper copies of the survey were placed at the three Iowa racetracks for patrons to fill out if they wished. Returned surveys were collected and the results compiled by IRGC staff. It should be noted that IRGC staff made suppositions as to the intent of some of the partial answers for a limited number of the paper surveys completed at the racetracks.

The survey included both coded and open ended questions. IRGC staff has limited experience with survey methodology and did not have complete custody of the survey forms nor does the study conform to scientific method. As such, the results do not indicate a confidence interval and can only be used as a guideline.

Approach and results of data. IRGC staff required participants to complete a consent form with each survey (Appendix-A). This consent form outlined that voluntary participation would assist IRGC staff in preparation of this report with all responses being confidential. The beginning of the survey questionnaire defined exchange wagering for the participants and contrasted that format to existing pari-mutuel wagering. Ninety-seven participants answered survey questions. These survey responses for each of the eleven questions are summarized graphically (Appendix-B). Viewing results in both bar and pie chart form may aid in understanding how this small sample size of participants view the prospect of exchange wagering in Iowa. It appears some questions did not produce clear results though readers of this

report may draw their own conclusions. IRGC staff encourages independent evaluation of the survey results though some material findings are highlighted here:

- Questions 5 and 9 found similar results though that was not necessarily the goal of the questions. When asked if exchange wagering becomes legalized in Iowa how often would you wager, 43% answered "Never". In response to utilizing exchange wagering more frequently; 47% answered "I will not wager via a betting exchange". While these responses are both less than half of total responses they are the highest percentage among their respective choices. Of course one may also conclude from the data that more than half of respondents would choose to participate in exchange wagering with varying frequency; 57% and 53% respectively.

- Question 8 revealed which regulatory measures respondents viewed as important. Race integrity was the most selected answer at 37%, followed by protection of funds 20%, and wagering integrity and audit trail in the event of a dispute and investigation 17%. Just 2% of respondents viewed prevention of underage gambling as most important.

- Question 10 results may depict how exchange wagering may affect visits to racetracks in Iowa to wager on live racing. The majority of respondents answered they would visit racetracks the same amount of time 58%. The remaining respondents answered they would visit the racetracks less often 26% or would visit the racetracks more often 16%; resulting in a net 10% visit racetracks less often to wager on live racing response.

- Question 11 looked at how exchange wagering legalization may impact pari-mutuel spending. The most popular response at 47%, answered that their pari-mutuel budget would remain the same and would not wager on the exchange. The remaining responses answered they would participate in exchange wagering with 25% of the respondents answering their

pari-mutuel budgets would remain the same, 18% of pari-mutuel budgets increasing, and only 10% of pari-mutuel budgets decreasing.

Methodology Limitations. One limitation of this study is the lack of historical data relating to the topic of regulation of exchange wagering in the United States. There is substantial information available in pari-mutuel racing and wagering, but exchange wagering is new to jurisdictions in the United States therefore, the data has not been tested over the course of a long period of time. Another limitation is the lack of data and information available for estimating the potential revenue impact of authorizing exchange wagering for licensees in Iowa. The information available is based on interviews of stakeholders related to their opinions on how it may impact the current pari-mutuel revenue. A considerable amount of discretion was applied to these estimates and it is likely actual results will vary from these projections. The survey given to pari-mutuel customers to obtain opinions on exchange wagering was not tested for reliability or validity. The survey was created by IRGC staff to help understand common concerns of pari-mutuel customers who may participate in exchange wagering. In addition, discretion has been applied by the researchers when analyzing the overall results of the data reviewed for this research.

Interviews. Interviews of individuals and industry representatives having expertise in various areas of pari-mutuel wagering or exchange wagering were conducted in order to obtain the most current information. A content analysis of the information received during the interviews was conducted. Interviews where substantial or relevant information was acquired are subsequently summarized in the report. The interview summaries are organized by area of expertise and then randomly placed within that summary area. Interviews and discussions were conducted with representatives of a number of stakeholders including: general managers and

racing directors at Iowa's racetrack casinos, representatives from the various horsemen's groups, other racetrack management, and a representative from Betfair.

IRGC staff had discussions with representatives from Caesars Entertainment who operate Horseshoe Casino at Bluffs Run Greyhound Park. They currently have pari-mutuel wagering at their facility and state that pari-mutuel has been a declining business over the past few years. Caesars management stated it's difficult for pari-mutuel wagering to compete with the casino because customers want instant gratification. They believe the brick and mortar casinos will decline in the future and an internet type platform will increase. For this reason, they feel the target market for exchange wagering are internet savvy individuals in their 30s and 40s looking for an interesting wager.

Caesars management believe accounts for exchange wagering should be opened on property so the facility can properly screen for underage gamblers, verify the identification of the patrons and check against the statewide self-excluded patron database. They have concerns and questions with regulation that include cheating, theft of the product, and accountability for revenue. Specifically, how will the exchange know when to close wagering? Who will lock/end wagering so one person doesn't have an advantage over another? Will the lock be tied to the tote system? Can a kennel employee wager on their animal to finish last and do something to the animal so it doesn't run to the best of its ability? How will the facility know all revenue figures are properly reported? The exchange wagering company could be taking wagers on ten different servers and only provide revenue figures for one server. Who would verify these figures? Caesars management stated the cost of maintaining the pari-mutuel product (animals and operation) is too high and believes there will be a few bigger tracks left that will offer their

product to remote sites. They also believe this type of wagering should be regulated and taxed the same as casinos in the state.

IRGC staff discussed the exchange wagering with a representative from the Iowa Greyhound Association (IGA). They feel the current pari-mutuel business is stable but uncertain with its survival in the long term. They don't feel exchange wagering will increase pari-mutuel wagering and it would be confusing for new gamblers. The representative also mentioned concerns with cheating if kennel people are allowed to wager on their animal. They don't believe wagering on the last place animal should be allowed. IGA concluded they are not for or against it, would look into it, but doesn't think it will be profitable.

IRGC staff met with management from Prairie Meadows Racetrack to discuss the current state of pari-mutuel wagering and the market potential of exchange wagering. At the time of this meeting, live on-track handle was up approximately \$75,000 while live off-track handle had increased more than \$2,700,000. Prairie Meadows keeps a larger percentage of on-track handle as revenue through the take out percentage. In addition, those people at the track are spending dollars on concessions or casino gambling other than just the horse race which has a much greater impact on the bottom line. Prairie Meadows' management stated that returning to the "glory days" of race wagering isn't going to happen for a number of reasons. A few of the reasons they listed were: field size being too small, racing the number of days they do can spread out the competition, horse racing doesn't grab the attention of younger people, and the horse industry struggles to promote itself effectively.

Prairie Meadows' management was cautious and unsure when speaking on the potential for exchange wagering. They gave the example from five years ago when numbers were being projected about on the market size and potential of ADW. They recalled being told the market

size in Iowa was as large as \$40 million. A second example given was the lack of action for utilizing exchange wagering in California where it has been legal for over four years without moving forward to implement allowing the wagering platform. Prairie Meadows' management was also concerned about diminishing returns. How much will it cost to contract or implement to gain how many dollars? The discussion circled back to the ADW example of advertised wagering levels versus the actuals realized and management's uncertainty that exchange wagering would do any more than what ADW is doing without cannibalizing from the current products, namely on-track attendance and handle and ADW handle.

IRGC staff interviewed management from Oaklawn, a horse racing track in Hot Springs, Arkansas. The Oaklawn representative had a dim view of exchange wagering since it appears it would further erode people in the grandstand and reduce the funds of what tracks and horsemen were collecting. He believes exchange wagering would cannibalize their current pari-mutuel revenues since the proposed takeout from an exchange wagering company was significantly less than what facilities currently collect with on-track wagering and simulcasting. This situation would leave the facility and horsemen with a far less cut of the revenue, thus he does not think it is a good product for racing in the United States since it would hurt the tracks, horsemen, and breeders.

A representative of the Iowa Quarter Horse Racing Association (IQHRA) also shared thoughts on exchange wagering with IRGC staff. The IQHRA representative believed industry attention should be on increasing field size and growing pari-mutuel pools. This would benefit bettors who are willing to wager more money on larger fields to take advantage of their handicapping work. The representative did not assume the exchange wagering platform would take away from the pari-mutuel pool as they see the exchange wagering player being someone

who likes the head-to-head action, similar to poker players. The IQHRA representative thought exchange wagering is something that can be done if it is handled properly. The representative also suggested IRGC staff review how it is being handled in Europe as the stories relayed from there are positive about exchange wagering. Specifically, the ability to see who has wagered what, where, and when can help alleviate the integrity concerns by analyzing wager patterns of suspicious lay bets or bettors.

IRGC staff met with the IHBPA to receive their thoughts on the current pari-mutuel wagering model and the potential of exchange wagering in Iowa. The meeting began with a discussion on the current state of pari-mutuel wagering in Iowa and then evolved to throughout the United States and then briefly to international. IHBPA feels the days of the week that Prairie Meadows has selected to conduct their live meet holds a great impact on the handle level of export simulcasting. They also believe the ADW market in Iowa should be \$10 million - \$20 million, but the current year's (2015) forecast is only \$2 million. Part of this is the fact Iowa only has one ADW licensed operator. The IHBPA representative expects there to be some cannibalization of the current ADW handle by an exchange wagering platform but expects the combined handle to increase 25 percent - 50 percent from the current year level of ADW handle. The noted disclaimer to that statement was dependent on when and how the product makes it to market. It is the representative's feeling that the handle levels would grow exponentially if first to the international market than to be third or fifth to market in the United States. Additionally on that thought, it is believed if the exchange were not an internet (nationally or internationally) model but rather just an intranet (wagers between Iowans only) model the exchange would not be profitable. The IHBPA shared they believe the ADW model is working very well and that the outline for licensing and regulation should be copied for exchange wagering. Doing so would

address some parties' concerns about underage account holders, problem gambling, and having Prairie Meadows checking the state offset database for any qualifying winnings. The caveat to the current ADW licensing structure was a suggestion that the number of licenses be limited to only one exchange. By licensing multiple exchanges the market size (liquidity) would be spread thinner and make the possibility of finding opposing bettors significantly more difficult.

Iowa Thoroughbred Breeders and Owners Association (ITBOA) had a representative meet with IRGC staff. Discussion regarding the current state of pari-mutuel wagering was centered on needing better education for new bettors, and looking at the option of offering different bets to increase interest. A disadvantage noted of the current race wagering entertainment is the twenty-plus minutes between post times; this large down time loses the attention of the younger generations. The ITBOA representative thinks exchange wagering has potential to grow interest in race betting, but recommends Iowa as a 'fast-follower' rather than the initial jurisdiction to implement. The horsemen don't want to miss an opportunity that could lead to more money for the track, community, and horsemen; but they can wait and see what California and New Jersey do right or wrong with their exchanges.

IRGC staff interviewed management from the California Horse Racing Board (CHRB). The representative didn't have much direct involvement with exchange wagering since he recently joined the CHRB. However, he stated the Board adopted complex rules and regulations to govern it and they also determined they needed sophisticated software to deal with potential fraud. He stated they researched and found software in England which would cost about \$500,000. The CHRB planned to pass the cost of the software to the licensee which brought some opposition. It was later determined the software was going to be double the initial price, or \$1 million. As to date, no software had been purchased. Regulatory concerns are the

potential for fraud. In addition, the CHRB would need to increase staff to properly regulate. The horse industry argued exchange wagering would be trading more lucrative dollars for less lucrative dollars and would not be as profitable. The licensees for exchange wagering used Europe as an example on how successful they would be but the horse industry argued the markets are not the same since it is culturally different. The CHRB representative stated the pari-mutuel business has leveled off in California. The field sizes are small and the cards have been reduced to four days a week. He does not see any changes in the next 10 to 20 years since the tribes have been against expanding gambling.

IRGC staff held a phone interview with Mike Rogers, member and on the Executive Board for the Stronach Group. The Stronach Group is a leading horse racetrack operator and supplier of pari-mutuel wagering technology (The Stronach Group, 2015). Mr. Rogers had points of advice for research areas the IRGC staff should review in compiling our report. He also gave examples of operating and regulatory framework. One topic discussed and recommended by Mr. Rogers was the uneasiness people have with the lay bets in exchange wagering. If a person makes a lay bet, they are betting for a negative result. Mr. Rogers recommends if exchange wagering were to be allowed in Iowa, the wagering rules should place a cap on how much a person could lay on a horse. A second area focused on by Mr. Rogers was the liquidity in the exchange market of Iowa. He stated with a population of only 3.1 million, less those under the legal gambling age of 21, the market in Iowa is small and to just operate within the state would be very difficult.

IRGC staff interviewed Darrell Vienna, a horse trainer for over 35 years, who is licensed to practice law in California, and has been elected to many boards to represent the horse interests in California. He performed research and was involved with exchange wagering when it was

proposed in California. He believes exchange wagering is problematic for two main reasons. 1) It encourages cheating since it is much more difficult to pick a winner than ensure a losing horse. In addition, trainers and owners could have a “sure thing” by not racing horses properly, treating the animal improperly or training improperly. He also feels lay bets on horses facilitates illegal practices which has been seen in Australia and England. 2) Exchange wagering also cannibalizes higher take out wagers. The returns (for the facility and horsemen) are minuscule compared to on-track and simulcasting percentages. Other concerns include having the exchange wagering service provider and the pari-mutuel facility fall under the same ownership. He stated this has happened in California and when negotiating the percentages (which is done between the service provider and the facility) there is nobody looking out for the best interest of the horsemen. Therefore, he recommends the service provider and the facility have an “arm’s length” relationship. Through his research he discovered the exchange wagering platform could be leased or purchased so there is not a third provider which he would recommend. He further had concerns with the current law in California which allows the exchange wagering provider to make a market. Meaning if there are uncovered bets at the close of wagering, the provider can cover the bets. The exchange wagering market can lay and bet in a way that the worst possible outcome for them is they break even. He believes if the aforementioned concerns are addressed properly then the exchange wagering platform could generate volumes of a different types of gamblers similar to option traders in the stock market.

IRGC staff reviewed exchange wagering with New Jersey Racing Commission. The representative from New Jersey stated they have utilized Gaming Laboratories International (GLI) to review the technology of the exchange wagering system. It is their intention to continue to work with GLI in semi-annual or annual ongoing reviews of the exchange wagering system.

The representative also indicated regulators would have access to “bet monitoring systems” to monitor betting trends. There was little opposition to exchange wagering in New Jersey outside of the local Jockeys’ Guild. There are still unanswered questions in New Jersey as it relates to who is allowed versus who is barred from making wagers, what types of wagering are allowed, and finally what does the revenue look like and who makes what percent of the wagers.

IRGC staff interviewed an executive with Churchill Downs Incorporated (CDI). The executive discussed his regular involvement in researching and asking questions while California was attempting to legalize exchange wagering a few years ago. He said CDI’s conclusion on exchange wagering is that they still have more questions than answers even after all of their hours of work. The main concerns the executive described to IRGC staff was the dollars back to the track producing the product, and a concern on holding horses back to make profitable lay bets. The executive believes exchange wagering will cannibalize more from the current pari-mutuel wagering pool than it will create in new customers. This factor, combined with an unknown revenue model to benefit the track and horsemen, is what led to their main concern of how the dollars flow in an exchange market. The executive compared exchange wagering to bookmaking as any of the participants in the exchange pool can set their fixed odds on the bet they desire. In contrast, the pari-mutuel pools are continuously adjusting their odds based on where the money is being wagered.

Data Presentation

The data presentation will address the requirements of SF 438 by reporting on the current state of pari-mutuel wagering in Iowa, the potential revenue impact of authorizing exchange wagering, and the possible regulatory framework necessary if exchange wagering is authorized. Data on the current state of exchange wagering and consumer protection measures are also presented to better understand how the industry has approached regulatory measures. Exchange wagering on other sports are not contemplated in SF 438 as this legislation only applies to pari-mutuel racing. No specific recommendations regarding the legalization of exchange wagering in Iowa will be made in this report, although some recommendations and comments on other considerations for the regulation of exchange wagering may be included.

Current State of Exchange Wagering.

Currently, internet betting exchanges for exchange wagering exist for pari-mutuel wagering in several European countries and Australia. In addition to pari-mutuel wagering on horses, these platforms allow for wagering on a wide variety of sports, markets and entertainment. In the United States, only California and New Jersey have statutorily authorized exchange wagering on horse racing, however neither jurisdiction has yet to accept an exchange wager. New Jersey has set forth rules and regulations for the operation of exchange wagering platforms within the state. Exchange wagering in California is currently on hold due to disagreements between stakeholders in the horse racing industry. Exchange wagering is a relatively new and unfamiliar wagering concept to the pari-mutuel racing industry and racing regulators in the United States. In the United States, exchange wagering would most likely be operated by an ADW operator on a web-based platform.

Exchange wagering in the United States would likely allow wagering on horse racing via an internet connection in jurisdictions where allowed by law. A betting exchange operator would allow for participants to create and fund web-based wagering accounts and allow participants to wager on horse racing against one another at their own odds and prices. Participants would have the ability to deposit and withdraw funds from their account on their own accord. Exchange wagering could be accomplished via desktop computer or any mobile electronic device with an internet connection. It could also occur directly through an exchange wagering operator's web-based application for electronic devices such as an Apple iOS application or Android application.

An exchange wagering platform operator utilizes computerized technology to match a participant's wager (back or lay wager) with an opposing wager at prices and odds upon which the participants agreed. The platform operator would likely take a commission or fee from a participant's wager or from winning wagers. In-play wagering is another unique exchange wagering option that is present on betting exchanges. In-play wagering is where a participant is allowed to wager on the exchange for a particular race while the race is in progress and until the race is declared official. Currently, all race and simulcast wagers in the United States must be placed prior to betting windows or terminals being locked from accepting additional wagers, such as at a brick-and-mortar casino or pari-mutuel facility that offers pari-mutuel wagering. At locations such as this, once the racing animal is loaded into the starting gates prior to the race beginning, the betting windows and betting terminals are locked and no longer allow for wagers to be made on the particular race. The only caveat with an exchange wager is that a person's wager must be matched with an opposing wager. This is also true for in-play wagering. If a person's wager is not matched at any point prior to or during the race, then the wager is

cancelled and the participant is not charged any commission or fee with the amount wagered being returned to their account balance.

One company providing web-based betting exchanges and exchange wagering is Betfair. Betfair is currently undergoing the licensing process in New Jersey and plans to provide a web-based exchange wagering platform for horse races at the Meadowlands and Monmouth Park racetracks. Exchange wagering in New Jersey is authorized, but exchange wagering has yet to be offered to the public. In addition, Betfair provides web-based betting exchanges in Europe and Australia. In the United States, Betfair also owns TVG, an ADW operator for horse racing and HRTV. TVG and HRTV operate racing television channels for the broadcast of horse races. TVG has operations in several states including California and New Jersey, two states that have statutorily authorized exchange wagering.

Although an actual exchange wager has yet to occur in the United States the web-based exchange wagering to be offered by Betfair in New Jersey is on horse racing only and does not include any other forms of pari-mutuel wagering. Betfair stated during a presentation to the Iowa Racing and Gaming Commission and stakeholders, that there are three wagers that can be made on the exchange wagering platform (Hindman, 2015). These wagers are win, place, show, and the consumer can set their own odds and prices. The exchange wagering does not include exacta, trifecta, or other exotic wagers. Betfair attempts to find a market for each wager made, but does not place a wager against the consumer if the consumer's wager is not matched by an opposing wager. Betfair also conducts real-time monitoring of their betting exchanges and works closely with regulatory agencies. Betfair's exchange wagering technology and software is in a testing phase by GLI for approval in New Jersey for horse races at the New Jersey

Meadowlands Racetrack and Monmouth Park. GLI provides testing, certification and professional services to the gaming industry throughout the world. According to Betfair, New Jersey will be the first jurisdiction in the United States to operate an exchange wagering platform (Hindman, 2015). It was reported Monmouth Park and Betfair reached a five year agreement and Monmouth Park will become the first track in the United States to offer exchange wagering (Martini 2014).

There are opponents to exchange wagering who are concerned it may cause a reduction of purse size which may result in less money for stakeholders involved in the race industry. This could possibly be due to an exchange wagering operator taking a percentage or commission of the monies typically wagered at a pari-mutuel facility. There is a belief of cannibalization of player's monies from a person physically wagering at a pari-mutuel facility and when they begin wagering on a web-based exchange wagering platform instead. Opponents also believe exchange wagering may make it easier to fix a race. Another concern is the in-play wagering option and any live transmission of a horse race may be subject to a broadcast delay thereby possibly giving an advantage to a participant. Additional concerns include underage gambling, problem gambling, age and identity verification, geo-location, fraud and money laundering.

New Jersey. In 2011, the New Jersey Legislature passed a law authorizing exchange wagering. The act authorizes exchange wagering on results of in-state and out-of-state horse races and exchange wagering is to only be conducted in accordance with a valid exchange wagering license issued by the New Jersey Racing Commission. Wagers may be taken in person, by telephone, or by communication through other electronic media from residents of

New Jersey by a licensed exchange wager operator. Revenues from exchange wagering are intended to subsidize racing purses (Cochran, 2015a).

Supporters of New Jersey exchange wagering contend it could draw new money to racing. With the New Jersey market containing four racetracks with pari-mutuel wagering, horse racing and off-track betting, exchange wagering is a way to attract new bettors to horse racing. In June 2014, the NJRC issued a proposal to establish rules for the implementation of exchange wagering which is authorized by the Exchange Wagering Act of 2011. The NJRC has the authority to prescribe rules, regulations and conditions under which exchange wagering may be conducted in New Jersey. The current status of exchange wagering in New Jersey at Monmouth Park and the Meadowlands is the testing and certification of Betfair's exchange wagering technology and software by GLI.

California. California authorized pari-mutuel wagering and exchange wagering on horse racing. The pari-mutuel and horse racing industry is regulated by the California Horse Racing Board (CHRB). In 2010, the California state legislature sought to authorize exchange wagering, which was aimed at reinvigorating a slowing market in pari-mutuel wagering. With a younger generation more adept and interested in newer, more technologically savvy ways to gamble, it was legalized with hopes that it would spur a renewed interest and generate more tax dollars (Smith, 2015).

The California exchange wagering legislation passed in 2010 and the CHRB created rules and the regulation of the exchange wagering. However, due to concerns from stakeholders and the horse racing industry, the implementation of exchange wagering has yet to occur. Concerns included wagers against a horse, race-fixing, purse concerns, and the percentage an exchange

wagering platform operator may take. Additional concerns were the integrity of the race and perhaps exchange wagering would provide incentive for trainers or jockeys to hold horses back in races, as well as cannibalization of existing pari-mutuel wagering.

After months of discussion and negotiations, the directors of the Thoroughbred Owners of California (TOC) reported in May of 2012 that the start date for exchange wagering would be delayed a minimum of twelve months because of concerns in the horse racing industry. They had continued concerns about the ethical implications of allowing wagers to be placed for horses for a loss versus a win, and trainers have even more concerns about what future legal issues this could bring for them if a horse continues to lose, yet makes monies for gamblers (Townend, 2012b). Opponents fear when wagers are allowed to be made against a horse, it will become much easier for a race to be fixed. Betfair had assumed negotiations were moving ahead in a positive manner and had anticipated exchange wagering to begin by the start of summer 2012, though there were still major concerns they would end up collecting a majority share of the purses available and the integrity of the race could be compromised. Betfair countered with confidence in their technology and confidence in preventing corruption, citing their agreement with the International Olympic Committee for an information sharing agreement (Batt, 2012). The TOC stated it needed additional time for research and development and to try to reach a compromise between all parties. Chairman of the TOC, Mike Pegram, stated the delay “will give us additional time to study this betting alternative and consider if it is in the best interests of the industry in our state” (Townend, 2012b).

Current State of Pari-Mutuel Wagering

In May of 1983, the Iowa Legislature passed the Pari-Mutuel Wagering Act allowing qualifying organizations to apply for a license to conduct pari-mutuel wagering on horse and dog racing. In July of that year, four licenses were issued, and in 1989 simulcasting was approved. These four licenses included (now) Racing Association of Central Iowa (Bondurant/Altoona), National Cattle Congress (Waterloo Greyhound), Dubuque Racing Association, Ltd, and Iowa West Racing Association (Council Bluffs). In 1991, Prairie Meadows filed for bankruptcy, somewhat following the overall nationwide decline in pari-mutuel racing and in 1992, the requirement for live performance racing for simulcast wagering was removed. In 1993, the Waterloo Greyhound Park also filed for bankruptcy.

In March of 1994, legislation was enacted to allow those racetrack enclosures existing in January 1994 to allow certain gambling games if approved by local referendum, prompting the opening of the nation's first three racinos at the current facilities of Dubuque Greyhound Park, Bluffs Run, and Prairie Meadows. This development improved profits significantly at all properties and especially at the financially challenged Prairie Meadows. By attracting new gamblers who also might participate in pari-mutuel racing, they were able to not only pay back the outstanding debt to the county and community, but supplement several local charities and community projects. This concept of racinos has not only proved beneficial for Iowa, but has been a model reused throughout the United States.

Legislation was enacted in 2011 allowing ADW at Prairie Meadows Racetrack & Casino. Specifically, this legislation allows wagers to be made via the telephone or internet on any pari-mutuel racing, and was put in place and active in 2012. Changes in 2011 also included

modifications to the purse structure with the divisions designated as 76% for Thoroughbred racing, 15.25% for Quarter-Horse racing and 8.75% for Standardbred racing.

Legislation enacted during the 2014 legislative session included several items related to greyhound racing which allowed the Iowa West Racing Association and Dubuque Racing Association to maintain a license to conduct gambling games without the requirement of scheduling performances of live dog races. This also allowed the Iowa Greyhound Association to apply for a pari-mutuel license to race greyhounds at Dubuque and established the Iowa Greyhound Pari-Mutuel Racing Fund under the control of the Commission. In October 2014, the Commission retained Spectrum Gaming Group to assist the Commission in determining how the monies in the Iowa Greyhound Pari-Mutuel Racing Fund will be distributed.

Effective in January, 2015, the Commission approved a request that the Iowa Greyhound Association would conduct greyhound racing and that the Dubuque Racing Association d/b/a Mystique Casino would be allowed to conduct gambling games as a gambling structure instead of a racetrack enclosure. After much debate, the Commission distributed the escrow fund created in a 1995 arbitration decision by providing that one-half of the escrow funds would go for purses at Bluffs Run, distributed on a prorated basis based on past purse earnings for the years 2011-2015, and the other one-half to the Iowa Greyhound Association for purses.

Live racing was first conducted at the State Fairgrounds and other county fairgrounds where non pari-mutuel racing had occurred for years with 30 performances in 1985 and live handle just over \$2 million. In 1989 Prairie Meadows hosted 170 performances and had live on-track handle of nearly \$38 million. With the additional gaming added at Prairie Meadows in 1995/96, the live track handle improved and held steady until 2001-2007 when it gradually

started to diminish downward. This trend has continued through today with Prairie Meadows live mutuel handle totaling approximately \$4.4 million for 2014. Additionally, while simulcast export of Prairie Meadows races reached a high of nearly \$68 million in 1999, it also has been trending downward and was approximately \$27 million in 2014.

Comparatively, simulcast import wagering has followed the same trend as live racing at Prairie Meadows. Simulcast wagering was not allowed prior to 1991 without live racing, but was approved and had its highest handles shortly following. Consistently averaging around \$20 million for several years, it began to taper off starting around 2003-2004. The simulcast handle for 2014 at Prairie Meadows for horse racing was approximately \$9 million.

Revenue Projections

Revenues from exchange wagering are generated in a different manner than traditional pari-mutuel wagering. With exchange wagering a commission, or percent of winnings, is charged on either the net winnings or bet winnings of the customer depending on how the operator or jurisdiction elects to charge. Betfair, during the presentation given to industry stakeholders in Iowa, discussed the model where commissions are charged on player's net winnings from each market/pool/race (Hindman, 2015). Under this scenario, the customer can take multiple positions within the race and then is charged a percent of the winnings after the race is final. This model, where commissions are charged on net winnings, encourages pool liquidity and would be favored by the customer; however it would diminish the overall commission base that could be received under other models.

Another way revenue can be received is to charge a commission on the individual bet winnings (Global Betting Exchange, 2015). In this model, commissions are charged on each winning wager within the race. Charging a commission on bet winnings maximizes the commission yield however decreases the liquidity of the pool and would reduce the attractiveness of the exchange wagering product to the customer (Global Betting Exchange, 2015). Under both scenarios, IRGC staff heard through presentations and interviews during the research that commissions could range anywhere from 5-15% of winnings. As noted earlier, this is different from the pari-mutuel revenue model where the takeout is approximately 15-25% of the overall pool, on every bet made, depending on the type of bet made by the customer.

The revenues generated from exchange wagering will likely be split-up in a manner similar to how ADW revenues are currently split-up in Iowa. During the presentation by Betfair, Betfair confirmed that the revenues would go to the exchange wagering operator, the host racetrack from which wagers are made on, the local racetrack (i.e. Prairie Meadows), and the local thoroughbred horsemen's group for purses (i.e. IHBPA). The specific allocation of how revenues would be split amongst the parties is unknown. Under the current pari-mutuel contracts approved in Iowa, host racetracks typically take first-fruits of total handle in the amount of 3-7%. Since there is no precedent for exchange wagering in the United States market, it is unknown if host racetracks will expect an amount of total handle or if they will adjust their fee due to the difference in how revenue is figured with exchange wagering. Under the current ADW contract in Iowa between TVG, Prairie Meadows, and the IHBPA: TVG receives 40% of revenue and Prairie Meadows and the IHBPA split the remaining 60% for revenues and purses respectively.

It is unclear if the State of Iowa will receive tax revenues as a result of adding exchange wagering to the wagering options at Prairie Meadows. It would appear there would need to be an increase in the amount of wagering generated from exchange wagering or there would need to be a change in tax law for the state to receive additional tax revenue. Pursuant to Iowa Code 99D.15, a tax of 6% is imposed on the gross sum wagered by the pari-mutuel method. However, Iowa Code 99D.15 provides for a tax credit of 6% if the gross sum wagered is below \$90 million in a year. In 2014, approximately \$4 million was wagered on-track on Prairie Meadows races, approximately \$27 million was wagered via simulcast on Prairie Meadows races, and approximately \$11 million was wagered at Prairie Meadows via simulcast on other racetracks across the country (2014 Annual Report, 2015). Given that revenue is based on net or bet winnings and not gross sum wagered under exchange wagering, it is uncertain how that would fit under the current Iowa law regarding pari-mutuel taxes. It is also unclear if total handle could be calculated under exchange wagering, if the totals from the three wagering sources noted in this paragraph count towards the \$90 million threshold that would trigger a tax, and if exchange wagering can legally be considered as a pari-mutuel wager. IRGC staff recommends if exchange wagering would be authorized in Iowa, Iowa Code 99D.15 should be amended to clarify if or how exchange wagering would factor into the pari-mutuel tax.

It is important to note there is no precedent in the United States to assist with determining the specific percent that can be expected from exchange wagering. In addition, it is speculative to determine the specific percent of revenue that will be expected from an exchange wagering operator or host tracks in the event exchange wagering would be legalized. It is also difficult to determine customer behavior with respect to the new wagering option if made available. Likewise, it is unknown how the Internal Revenue Service may treat withholding behavior on

winnings from the customers that participate in exchange wagering (Global Betting Exchange, 2015).

To get a picture of the potential revenue to be generated by Prairie Meadows, along with the horsemen's groups, from exchange wagering we must first understand the current wagering of Iowans into pari-mutuel pools. There are currently three different areas IRGC staff looked at: wagering at Prairie Meadows on live races, wagering at Prairie Meadows on import simulcast races, and wagering through ADW. Exchange wagering is only designed for win, place, or show wagers (WPS). As such we reviewed the total amount of handle for the three described wagering areas and the percentage of the total handle which was comprised of WPS wagers. Those numbers for calendar years 2013 and 2014 can be seen in Chart A below:

	2013	WPS	Handle	Percent
Live On Track	\$ 2,273,775.00		\$ 4,231,506.60	53.73%
Import	\$ 4,698,216.00		\$ 12,016,270.50	39.10%
ADW	\$ 640,802.00		\$ 1,336,218.40	47.96%
	2014	WPS	Handle	Percent
Live On Track	\$ 2,405,504.00		\$ 4,355,566.60	55.23%
Import	\$ 4,069,107.00		\$ 10,816,986.60	37.62%
ADW	\$ 820,302.00		\$ 1,719,079.10	47.72%
WPS Percentages	2013		2014	
Live On Track	53.73%		55.23%	
Import	39.10%		37.62%	
ADW	47.96%		47.72%	

IRGC staff inquired during a presentation by Betfair as to the potential cannibalization that TVG has observed in other markets of ADW handle when exchange wagering was

introduced. Betfair responded they believe they are growing the entire market in the long-run, but do expect a short-term impact of 10% of the WPS wager handle.

In Iowa, ADW continues to grow with the projection to be at \$2 million in handle for 2015. If the ratio continues where WPS is approximately 48% of total handle, WPS handle is projected to be \$960,000 in 2015. If 10% is removed as cannibalization to exchange wagering, \$96,000 is lost in ADW handle. This reduction from ADW equates to approximately \$7,500 in revenue which would be split equally between Prairie Meadows and designation for the following years' purses.

To estimate the revenue generated from exchange wagering we must make a number of assumptions. Our first assumption is that the market for exchange wagering will be similar to that of ADW after the initial year(s) of establishing the product. ADW was introduced in Iowa in 2012, and three years later the projected handle is \$2 million for 2015. If we assume that exchange wagering follows a similar path, then in two to five years the handle will be \$2 million.

The second assumption to determine revenue for our example is to understand that the takeout is charged on net winnings and not handle in this demonstration. Net winnings are the sum result of all wagers on a single racing event. If a customer makes two wagers on a race, the first winning \$50 and the second a loss of \$20, the net winnings for the race are \$50 won less the \$20 lost or \$30. Thus, we need to assume a ratio of handle that will be the net winnings. This is a complex issue that IRGC staff was unable to find much supporting data for in our research. As all horse races are dealing with odds, the wagers are not offsetting; meaning a wager of twenty dollars for the horse to win is not mirrored by twenty for the horse to not win, but rather a multiple of the twenty dollars based on the odds created by the exchange market.

To further clarify in an example, a horse with odds of 4:1, or 5.0 as shown on an exchange, would have a wager of \$20 to win matched with a wager of \$80 for the horse to finish other than win. In this example the handle is \$100. If the horse wins, the winning bettor has net winnings, for just this wager, of \$80. And vice versa if the horse did not win, the lay bettor would have net winnings, again for just this wager, of \$20. As one can see, the takeout is not on handle or a simply identified fraction of handle. Using a net winnings base has many factors ranging from the level of market odds for a race to whether favorites or long-shots are winning more races. From our research we determined a reasonable rate of net winnings of handle to be 40% (Global Betting Exchange, 2015).

As we have already discussed, based on the revenue model used, the takeout rate varies between 5-15%. As we are using the assumption of takeout being charged on net winnings, we will assume a higher takeout rate of 14%. We will also make the assumption the host track fees will be a stated percentage that is charged on the net winnings, or accounted for first from the takeout. IRGC staff elected to go middle of the road with the takeout rate and chose 4%. We then simplified the takeout calculation to create a 'net takeout', which is the takeout rate of 14% less the 4% host track fees, to leave a net of 10% to be split among Betfair, Prairie Meadows and purses for the following year.

As there are no markets currently operating within the United States there is limited information for IRGC staff to review regarding the actual split of our net takeout. IRGC staff made the simple assumption the revenue sharing model would mimic that of the ADW agreement with Betfair (TVG) in that Betfair receives 40% while returning 60% to be split equally between Prairie Meadows and purses. Below one will find a chart summarizing our

assumptions, to assume a potential revenue figure for Prairie Meadows and purses based on different handle levels.

Handle	\$ 2,000,000	\$ 5,000,000	\$ 10,000,000	\$ 20,000,000
Net Winnings	\$ 800,000	\$ 2,000,000	\$ 4,000,000	\$ 8,000,000
Takeout rate	14%	14%	14%	14%
Host Track fees	4%	4%	4%	4%
Net takeout	10%	10%	10%	10%
Fees collected	\$ 80,000	\$ 200,000	\$ 400,000	\$ 800,000
Operator fees	\$ 32,000	\$ 80,000	\$ 160,000	\$ 320,000
Revenues to PMRC/Purses	\$ 48,000	\$ 120,000	\$ 240,000	\$ 480,000

From this chart one can see that with a volume of \$2 million in handle, which we expect to take 2-5 years to generate, and with our assumptions listed, the revenue from exchange wagering to Prairie Meadows and future purses would exceed the \$7,500 of cannibalized revenue lost from ADW. This is not to assert that exchange wagering is a no loss proposition as many of our assumptions could sway to an extreme where there is larger cannibalization, the net winnings is a smaller percentage of handle, and the host fees required by racetracks to allow their signal to be used for exchange wagering by Iowans could be higher or remain a percentage of handle rather than a portion of the takeout rate. To the same degree, the exchange wagering may draw a significant percentage of their customers to ADW for the exotic wagers, creating a larger takeout, or net winnings that are greater than our assumption. Another factor would be the exchange is run with a takeout on 'bet winnings', or the amount won from each individual wager rather than netting all wagers from a single race together to find net winnings. These factors would lead to greater revenue for Prairie Meadows and the purse pool than what we have shown.

It is important to keep in mind handle generated from exchange wagering will produce less revenue to Iowa interests than equal handle through ADW, live, or simulcast wagering. The factor is unknown to IRGC staff, but in our example we had estimated 40% of exchange wagering handle will be the level of net winnings on which the operator could charge their takeout rate. As exchange wagering only provides markets for win, place and show bets, the takeout rate and subsequent revenue sharing could be near similar to what is seen with ADW, live, and simulcast. Overall, the assumptions used are highly speculative and potentially volatile. Further information should continue to be reviewed from operators or jurisdictions as they begin their operations.

There appears to be opposite views with respect to exchange wagering being profitable and ultimately beneficial, for the racetracks and racing purses throughout the industry. One position is that overall racing handle will increase because people not familiar with racing and wagering will be interested in the concept of exchange wagering. Eugene Christiansen of Christiansen Capital Advisors is reported as saying people like exchange betting and that it appeals to people who are not currently involved in fixed-odds betting or pari-mutuel betting (Mitchell, 2011). That is consistent with remarks made by Dennis Drazin, advisor to Monmouth Park, who claims that exchange wagering is a different product geared towards an off-track demographic that may track or play the stock market on mobile devices (Martini, 2014). Drazin and Betfair also claim the new concept of wagering called in-play will attract a new group of fans to horse racing (Martini, 2014). Christiansen points out the pricing model has yet to be set in the United States market, but that United States racing customers want lower prices and exchange wagering is able to offer much lower prices. (Mitchell, 2011). Betfair indicated during their presentation that even though lower prices will be offered to the racing customers, it only

impacts the win, place, and show pools since these are the types of wagers made with exchange wagering (Hindman, 2015). Betfair and Christiansen report the win, place, and show pools are typically about 30% of the money of any given race, therefore there is little cannibalization of that market and it is offset by the increased play of non-traditional wagering customers (Martini, 2014). In addition, Betfair stated new customers to race wagering drawn into the industry by exchange wagering will periodically place traditional pari-mutuel wagers with higher takeout wagering options when pools for pick “n” wagers become attractive (Hindman, 2015).

Another position is that overall revenue will decline because the lower revenue generating bets made through exchange wagering would cannibalize the higher revenue generating pari-mutuel bets made through traditional wagering. The thought is that the new customers brought to the wagering market would not be enough to offset the revenue lost for those players shifting their bets from pari-mutuel to exchange wagering. Essentially critics argue because of this market shift if exchange wagering were to be authorized, exchange betting operators like Betfair will take the lion’s share of purses away from horsemen, jockeys, and other track personnel (Batt, 2012). The Stronach Group threatened a lawsuit against the CHRB if it approved exchange wagering for its tracks (Batt, 2012).

It is important to review Iowa law related to racing purses and ADW when making a determination how either position would impact the revenue for Iowa industry participants. Iowa Code 99F.6 states, in part, that any agreement related to horse purses must provide for purses of 11% of the first \$200 million in gambling receipts. Iowa Code 99D.11 calls for, in part for ADW wagers, 50% of revenues, less expenses, shall be designated for horse purses. Under the position where overall racing handle will increase to the extent there is little or no

cannibalization of traditional pari-mutuel wagering, every stakeholder will increase profits. Purses will increase, additional revenue will be generated by Prairie Meadows, and the exchange wagering operator will receive revenue. However, under the position where cannibalization occurs reducing the amount of higher revenue generating wagers that would not be offset by the lower revenue generating exchange wagering, Prairie Meadows will incur a net loss to their racing profits. Purses may still increase because the purses will consist of the 11% from gaming receipts, and the additional monies from ADW and exchange wagering. The 11% minimum is paid no matter if there is an increase or decrease of pari-mutuel wagering. Also under this position, the exchange wagering operator would receive net gains.

Consumer Protection Areas

Research and data was collected on possible consumer protection measures and regulations that could be implemented in an exchange wagering environment. Consumer protection covers several areas that include: licensing of exchange operator(s), identity and age verification, network security, system auditing, race integrity, and geo-location. These issues will be the focus of the consumer protection research.

Licensing of the Exchange Operator(s). Utilization of a betting exchange is a new concept to the United States markets and the Iowa jurisdiction. There should be a large online or internet component to the exchange. IRGC staff should continue to do suitability assessment for the exchange operator(s) and any third party companies that provide services for the exchange operator. The purpose of IRGC's licensing process is to ensure there is no criminal activity associated with the company administering the betting exchange and that the gambling activity is fair and legal.

The licensing process should be very similar to what IRGC staff used for ADW (see IAC 491-8.6(1) in its entirety). The exchange operator should have an operating agreement with the IHBPA and Prairie Meadows Racetrack and Casino. This operating agreement as well as a written detailed plan of how the exchange functions must be submitted and approved by IRGC prior to implementation. IRGC staff should also use due diligence by having all necessary background investigations completed for directors, ownership interests, key employees, or anyone else deemed necessary.

The exchange operator should have to provide a bond or letter of credit to IRGC due to the fact they will be holding funds that need to be paid out to the wagering public. This licensing requirement should help the public feel secure their funds will be available for immediate access. The amount of the bond or letter of credit will be set by IRGC staff.

IRGC staff should draft rules similar to Iowa Code 99D, Iowa Code 99F and Iowa administrative rules 491 IAC 5.4(5)“c” which would require the betting exchange operator to report any incident involving employee theft, criminal activity, age violations, or racing receipts. Lastly, any Iowa regulatory framework regarding exchange wagering should include similar language that would apply to any internet hub operator working with the exchange operator that would require reporting incidents to IRGC staff as well as authorizing unlimited access to all areas of the internet hub operation including records and information.

Identity and Age Identification. Iowa law and administrative rules require participants in gambling activity to be 21 years of age or older to place wagers. Even though a betting exchange would legally allow online wagers to be accepted, IRGC should have the same rules

regarding the legal age and would require the exchange operator to ensure all participants who wager are of legal age.

Many companies have various technologies for identity and age verification purposes for participants gaming in an online environment. These companies have software that matches personal information from the participant to government and other databases to properly identify the subject and their age through a series of questions.

The process of identifying a participant's age is not without concern. Family or friends of someone who is under 21 years of age could circumvent policy and procedure by setting up an account and allowing the underage subject to participate illegally. Utilizing someone else's legitimate information can be problematic regarding age and identity verification. As a deterrent, IRGC could ask the legislature to create laws stating unauthorized gaming by minors or anyone helping the minor to access accounts illegally would constitute a crime. Any regulation or law concerning exchange wagering in Iowa should address concerns of player account identification in order to prevent underage gaming, identity theft, or other criminal activity.

Network Security. The security of the exchange wagering network is an important issue when considering regulations. Aspects of network security include financial transaction security, identity theft, money laundering, illegitimate betting, and any other system areas that could have a negative impact on the integrity of racing. Any regulation of exchange wagering should address these concerns and provide a regulatory framework for auditing the system software and testing procedures. This framework may require the provider of the network to be able to detect types of cheating and wagering irregularities. It may also call for some ability by the regulator to

monitor what the provider is observing and what information is being obtained to assure the integrity of the betting system and the races being bet on.

In order to participate in online exchange wagering players would be required to set up accounts, then make deposits into those accounts to place wagers. Methods to ensure the availability of player funds and security of player accounts should be part of any regulations developed for exchange wagering. Current Iowa gaming law require brick-and-mortar casinos to submit an external audit of their gambling operations to IRGC annually. These or other types of regulations that address player access to their accounts should be incorporated to ensure safe financial transactions within the framework of the exchange wagering website. External threats to the security of the exchange wagering website with respect to player accounts should also be considered. Third-party information technology companies could be utilized to perform periodic penetration tests and to report on or provide recommendations to the exchange wagering website in the area of account security.

Identity theft is a viable threat in any online enterprise that involves the obtainment of personal information. Any compromise of the network's security could result in participants' personal information being stolen which could lead to identity theft and fraud. Providers of online wagering sites often utilize third parties to provide identity and account protection. For example, Betfair contracts with a company called HydrantID to provide digital identity protections and encryption services ("Betfair Selects HydrantID to Provide Digital Identity and Encryption Services for World's Largest Internet Betting Exchange", 2015). In 2008, the largest identity theft ring in United States history was broken up by United States authorities. Eleven people residing in five different countries were charged with various identity theft crimes after

stealing personal information of 150 people from online gambling sites (Costigan, 2008). Identity theft rings will continue to target online wagering sites because of the obvious presence of participants' personal information.

Money laundering is the disguising of illegal sources of money and making the money appear legitimate and legal. According to the American Gaming Association, "the risk of money laundering with currency is eliminated from online gambling sites that do not accept currency," and "every financial transaction with an online website is recorded and therefore subject to audit and questioning by both the operator and regulators (Stewart, 2011)." John Hindman of TVG says exchange wagering bets are monitored with a "complete audit trail" and are not anonymous, unlike many cash wagers at the track, there is even more transparency than with traditional betting (Gantz, 2014). The exchange wagering provider should be able to provide regulators and authorities with complete data both in real-time and historically, and as such money laundering and other illegal financial transactions appear not to be a prevalent threat within the framework of the exchange wagering network.

Testing and Auditing of Software. The participant, operator, provider and regulator all must be completely confident the network security provides adequate protection from hacking as to prevent cheating by manipulating the betting system. The approval and testing of the exchange wagering network and player security should be incorporated into regulations. The State of Iowa does not have its own technology testing lab. IRGC staff utilizes GLI and BMM Testlabs, both independent testing facilities, for testing of electronic equipment, including slot machines and gaming systems. GLI is currently performing the network and system testing for New Jersey as they move towards implementing exchange wagering through Betfair. Should exchange

wagering become legal in Iowa, IRGC staff anticipates utilizing an independent testing lab for the testing of the security of the online exchange wagering network provider as well as to analyze the provider's system for monitoring possible cheating. In addition, California regulators stated they researched and found sophisticated software to help detect fraud and other forms of cheating. They discovered a product from England they felt confident with and would utilize if exchange wagering was operating in California. Further research should be made to determine if independent software would be necessary or beneficial to help recognize cheating or fraudulent conduct.

Software auditing is also needed in the prevention of system errors. One technical problem occurring in 2011, involving the site provided by Betfair, resulted in compensatory payments being made to bettors on the affected race ex-gratia. The glitch "allowed one gambler on the site to use an automated trading system to lay bets" far in excess of the amount that was actually in his account (Townend, 2012a). Other incidents have seen the automated system allow bets at incorrect odds or allow bets after the horse had crossed the finish line (Townend, 2012b). The ability to audit both the network provider and the operator is an essential component to effectively regulate exchange wagering. Network security audits can make providers, operators and regulators aware of potential security risks before they can be exploited. Network security auditing results should be submitted to regulators in a timely fashion and any deficiencies should be immediately addressed by the operator. The software audit should be comprised of a wide-ranging review of the network's adherence to the regulatory guidelines. It should include what data is handled and how it is stored and transmitted. Information should be obtainable from an audit trail that reveals and validates any and all computer activity.

Race Integrity. Critics and industry participants have voiced concerns exchange wagering could lead to potential race fixing and provides incentives for trainers, owners, and jockeys to hold back horses in a race. While exchange wagering companies state they closely monitor its service and alert regulatory authorities to suspicious bets, there hasn't been information provided from the operators showing there is a system in place that interfaces with licensees and wagers associated with the horses they are involved with. Therefore, minimizing the risk for cheating would take a joint effort of strong regulation, proper auditing of accounts and wagers, and self-reporting by industry participants.

Lay Bets. Lay bet, as defined by New Jersey Racing Commission, means to wager on a selected outcome not occurring in a given market (New Jersey Racing Commission, 2014). With these forms of wagers, a jockey or trainer could bet on their horse to not win, place, or show. There is concern from industry participants, regulators, and the wagering public that people who have direct involvement on the outcome of a race not be allowed to make lay wagers.

There have been several documented incidents involving exchange wagering where law enforcement authorities have charged people with offenses related to allegations of fixing the outcome of horseraces. In addition, there have been several imposed sanctions from the racing industry related to dishonest conduct. For example, in 2011 five jockeys and two owners were charged with "serious breaches" of the rules of racing in relation to horses that were laid to lose on the betting exchange. Two of the jockeys were banned from racing for twelve years for "not riding a horse to its merits", the owners were banned for fourteen years and others were found guilty of "corrupt or fraudulent practices" (O'Connor, 2015). Cases from Australia and the British Horseracing Authority have shown licensees who play a vital role on the outcome of a

horserace have used inside information and placed a lay bet on a horse. In these cases reviewed, the licensees involved have received stiff sanctions for violating these rules.

Licensee Wagering. Licensees have a significant influence on how an animal under their care can perform. Each person involved in the day-to-day care and routine of a horse not only help the horse run better but they also have a substantial influence on a horse not running to the best of its ability. The jockey can choose to push the horse to run to its potential or not ride the horse properly. Other licensees can treat the animal improperly or can train the animal improperly which could have a negative outcome on the performance during a race. Lay wagers for certain licensed individuals working in the racing industry are prohibited in jurisdictions that have created administrative rules for exchange wagering such as New Jersey and California. Therefore, as seen in other jurisdictions, certain racing participants should be prohibited from making lay bets on animals under their care.

The following is a list of licensees that have significant involvement with a horse and should not be allowed to place a lay bet on their horse. The list includes the trainer, assistant trainer, or substitute trainer who trains the animal; the authorized agent who represents the owner of the horse; the jockey or driver who rides or drives the horse; the valet who attends the jockey; any stable employee of the trainer who trains the animal; the veterinarian or any assistant to the veterinarian providing services to the trainer who trains the animal; or shall anyone in this section lay an animal to lose on their behalf, or receive the whole or any part of any proceeds of such a lay.

While IRGC staff was interviewing participants throughout the industry, many of the individuals including operators at the facilities expressed the desire to disallow lay wagers for

licensees with their own horse. Horseracing has many facets on the backside of the operation and as previously stated there are many people involved in the day-to-day handling of racehorses that are essential to the proper care of these animals. However, these people have inside information if a horse is sore, injured, or has any other issues which would not allow the horse to run to the best of its ability. There are cases when a horse may be coming back from an injury or medical condition and the owner or trainer would like the horse to enter a race so it doesn't run out of days for qualifications. In this type of instance the owner and trainer may request the jockey hold up or not push the horse because it's not 100% ready. With these types of situations, licensed individuals could benefit from knowing the horse, which could be a favorite, would not be pushed to run to its best ability. Knowing and utilizing this type of information on exchange wagering could be construed as unfair or cheating to the patron who was unaware of the inside information. Further research would need to be done on potential rules or regulations for licensees involved with insider information in the event exchange wagering is approved.

Gambling Robots (Bots). Software which uses a gambling website's application programming interface to speed up the process of placing bets based upon a gambling system or betting strategy to decide which bets to place. A patron using a bot can set wagering parameters to ensure a positive or very small negative outcome since a bot is directly linked to the site and processes odds faster than any human player can. A human player obviously cannot calculate and wager as fast as a computer which gives an advantage to patrons utilizing a bot to place wagers. Exchange companies are aware of the bots in operation and may have separate deals with them. For example, if you log into a Betfair account using a bot, you can communicate directly with the Betfair database. This may allow bots to have quicker access to price updates than a human would if they used the web interface. This is another area that would need further

research to ensure all wagers and changing odds are available to all users in a timely manner and ensure bots are not provided information that isn't available to human users.

Timing of Wagers. The exchange may experience delays on wagers made due to factors outside of their control. For example, bettors may experience simulcast races at a slower rate than bettors watching the races live or in real-time. Transaction speeds may also be affected by multiple factors such as internet connection speed, mobile network capabilities, or hardware capabilities. This is recognized by ADW operators as demonstrated, for example, by a warning displayed on the Betfair website to alert customers to some of these factors. This is an area where further research may be necessary.

Location Restrictions. Maintaining requirements prohibiting gambling by persons outside the geographical jurisdiction authorized is important for protecting the integrity of any authorized online gambling. Geo-location software, as well as user identification, has been used as the primary means for identifying and restricting gambling from users outside of designated geographical locations. Geo-location software identifies a user's geographical location using the internet protocol (IP) address associated with the connected device. The IP address is used with a database of locations associated with IP addresses and the general location of the user can be found. While this software offers an automated and general way of obtaining a user's location while participating in online gambling, there are varying degrees of accuracy. Concerns have been raised about the level of assurance such software can offer when eliminating players from playing from unauthorized locations. In "Can Internet Gambling Be Effectively Regulated? Managing Risks" by Malcolm Sparrow, several figures are cited placing the accuracy of geo-location software between 70 to 99% (2009).

One company providing geo-location services, Quova, states geo-location is also used by internet websites offering live audio and video streaming of professional games to subscribers. These websites must identify their user's geographic location so the webcasts don't infringe on the high value contracts paid to sports team owners by national and local television broadcasters. By implementing IP geo-location into these websites, a broadcast can restrict access to ineligible users by state and country for national blackouts or by zip code for local blackouts. Despite the current uses of geolocation services in these broadcasts, in two documents provided by Quova, "Quova Geolocation: Ensuring Compliance with Online Gaming Regulations" and "Quova Getting Back in the Game: Geolocation Can Ensure Compliance with New iGaming Regulations", Quova notes some of the limitations of geo-location by IP address (2010a & 2010b). Specifically, geo-location data can help identify the location of the IP address at the country, state, and city levels, however that IP location may not be the same as the user's location. According to Quova, robust analysis of the accuracy of publically available geo-location data, as well as a comprehensive policy to tackle IP address discrepancies can address some of the issues associated with location determination, but no specific figures are provided (Quova, 2010a and Quova, 2010b). A concern for exchange wagering is the accuracy and reliability of geolocation technologies to identify a user's true location. Based on information provided by Ed Honour, accuracy of geo-location database varies depending on which database is used (Honour, 2011). For IP to state database, some vendors claim to offer 98 to 99% accuracy although typical IP to state database accuracy is more like 95%.

According to the American Gaming Association (AGA), to enforce each state's determination, online gambling operators will have to ensure only bettors from authorized jurisdictions can play on their sites. Identity checks can be reinforced by geo-location systems

that locate the IP address of the computer the customer is using. Existing databases of IP addresses will reveal the jurisdiction in which the customer is located, except when that location is close to a geographic border or is otherwise cloaked. AGA stated there are techniques for defeating geo-location systems and suggested a territorial screening system can identify when those techniques may be in use. An online gambling operator can then decline to provide service until a customer provides additional evidence of location (Stewart, Ropes, & Gray, LLP., 2011). The Illinois Internet Lottery Pilot Program white paper discussed the use of anonymizers which are applications designed to hide the end user's location by acting as a buffer between the user and the website visited. In this situation, the user's IP address is only transmitted to the provider of the anonymizer and then is assigned a new IP address by the anonymizer in relation to any websites visited. However, the white paper discussed that Quova has developed the ability to detect the use of known anonymizers which allows it to determine when an end user is attempting to mask their location (Illinois Department of Revenue Illinois Lottery, 2010). Additional concerns include the ability of a participant to access a home computer while not being present and accessing the betting exchange network. According to the State of Illinois' Internet Lottery Pilot Program white paper, VPN or mobile gateways can circumvent the ability to accurately pinpoint the end users actual location. However, the white paper indicates the type of internet connection associated with these types of IP address coupled with routing characteristics of the IP address can indicate risk to accurately verify the end users location and, therefore, a user's account can be blocked (Illinois Department of Revenue and Illinois Lottery, 2010).

LOC-AID, a company that currently offers location services based on mobile phone carriers to determine the location of users, has offered an option in minimizing some of the risk

in traditional IP geo-location services. While primarily involved in the use of mobile phones to make and place bets, the geo-fencing services used in these forms of gambling could be used in conjunction with IP geo-location. These services could require that any person placing a bet on an online site utilize a mobile phone at the time of login, either to receive or send a text message. Using currently available mobile phone technology, this method could locate a user within a 5 to 5,000 yard radius, compared to an IP geo-location solution which generally gives a user's location within 10-50 miles.

In most situations, geo-location software can be combined with certain user registration prohibitions. Generally, requiring residency in the authorizing jurisdictions provides several options for regulations to confirm address and location information prior to allowing any online gaming to take place. An additional safeguard in ensuring the location of the user could also include a requirement for the financial account or payment method used by the patron to have the same address as the registered account address. Some jurisdictions where internet gambling is legal have also required that accounts can only be set up or only accept payments from people with a registered mailing address. In all cases, residency within the state could be confirmed using more stringent registration processes in initial setup of an account as well as utilizing aforementioned identity verification procedures. In the case of restricting access to online gaming to the desired geographical location, there are several methods, when combined, which offer some assurance the restrictions are met.

While methods are constantly evolving, there are still many questions as to the accuracy and compatibility of these resources, therefore further research on the topic of geo-location and residency may be needed to determine the acceptable ranges and levels of accuracy allowed or desired when developing the regulatory framework for this area.

California and New Jersey are the only two jurisdictions that have approved administrative rules for exchange wagering in the United States. New Jersey's regulations only allow exchange wagers from New Jersey residents within the physical borders of New Jersey. California regulations allow residents of other states to establish accounts and make wagers as long as it is not unlawful under United States law or the law of that state from which the patron is placing a wager. Applicable administrative rules would need to be reviewed and clarified once wagering location details are determined.

Summary & Conclusions

As required by SF 438, the report addresses the topic of exchange wagering. Exchange wagering, as defined by SF 438, is a form of wagering in which two or more persons place identically opposing wagers in a given market. The intent of the report is to provide policymakers with information so they are able to make an informed decision concerning the possible authorization of exchange wagering.

The report considered the current state of exchange wagering by conducting research from industry participants who are familiar with the subject, by reviewing current events in New Jersey and California where exchange wagering is legal but not operating, and by researching foreign jurisdictions where exchange wagering is legal. The current state of pari-mutuel wagering in Iowa was discussed as part of this report in an effort to understand the history of pari-mutuel wagering in Iowa, in addition to considering the successes and challenges related to pari-mutuel wagering in Iowa. The potential revenue impact of authorizing exchange wagering was reviewed in an effort to understand if or how much of an impact the potential addition of exchange wagering will have on purses, operator's revenue, and taxes to Iowa. Lastly, extensive research was conducted and reported in the area of consumer protection, including but not limited to, identity and age verification, network security, auditing of wagering software, race integrity and making lay and in-play wagers, and licensing of entities participating in the industry.

Current State of Exchange Wagering. Exchange wagering occurs in many European countries and Australia on web-based betting exchanges. The exchanges exist for consumers to

place wagers at the prices and odds of the consumer's choice with an identically opposing wager needed to match the wager in a given market. Web-based betting exchange operators use technology to match supply and demand wagers on a wide range of activities including horse racing, sportsmarkets, and entertainment. A valid matched wager is formed when two or more persons are confirmed by the exchange operator as having identically opposing wagers in a given market. A web-based exchange provides consumers a unique wagering opportunity as compared to traditional methods of wagering.

In the United States, exchange wagering is statutorily authorized in California and New Jersey for pari-mutuel horse racing only. New Jersey has set forth rules and regulations for exchange wagering at Monmouth Park and the Meadowlands Racetrack facilities. Although statutorily authorized, neither jurisdiction has yet to accept an exchange wager. One online betting exchange, Betfair, is currently undergoing the New Jersey licensing process to operate the state's first web-based exchange wagering platform for residents with a goal to accept the first exchange wager in 2015. California's exchange wagering is currently on hold due to disagreements between stakeholders in the horse racing industry.

Pari-mutuel wagering in Iowa. In 1983, the Iowa Legislature passed the Pari-Mutuel Wagering Act allowing for qualified sponsoring organizations to apply for a license to conduct pari-mutuel wagering on horse and dog racing. In 1984, four facilities were issued licenses. The four licensees were the Racing Association of Central Iowa, National Cattle Congress, Dubuque Racing Association Ltd and the Iowa West Racing Association and in 1989 simulcasting was enacted.

Following some decline in pari-mutuel racing, Prairie Meadows filed for bankruptcy in 1991. In 1992, the Iowa requirement for live performance racing to conduct simulcast wagering was removed. In 1993, Waterloo Greyhound Park filed for bankruptcy. In March 1994, the Iowa legislature enacted legislation to allow racetrack enclosures existing in January 1994 to allow certain gambling games if approved by local referendum. As a result, racinos came into existence at Dubuque Greyhound Park, Bluffs Run and Prairie Meadows. This increased profits and allowed for debt repayment, charitable contributions, and the funding of community projects. The racino concept in Iowa has been a model used throughout the United States due to its success.

In 2011, ADW was approved for use at Prairie Meadows and implemented in 2012. ADW allows consumers to place wagers via telephone or internet for betting on pari-mutuel racing at Prairie Meadows. Additionally in 2011 purse structures changed for horse racing at Prairie Meadows. In 2014, the Iowa West Racing Association and Dubuque Racing Association were allowed to maintain a license to conduct gambling games without the requirement of scheduling performances of live greyhound races. This allowed for the Iowa Greyhound Association to apply for a pari-mutuel license to race greyhounds at Dubuque and established the Iowa greyhound pari-mutuel racing fund under the control of IRGC. IRGC retained Spectrum Gaming group in 2014 pursuant to Iowa Code 99D.9B to assist IRGC in determining how the monies in the fund will be distributed to the greyhound industry.

In 2015, IRGC approved a request for the Iowa Greyhound Association to conduct greyhound racing at Dubuque and the Dubuque Racing Association, would be allowed to conduct gambling games as a gambling structure instead of a racetrack enclosure. IRGC also

distributed the purse escrow fund, created in a 1995 arbitration decision, with one half for purses at Bluffs Run, distributed on a prorated basis based on past purse earning for the years 2011-2015 and one half to the Iowa Greyhound Association for purses.

The live racing handle and simulcast wagering at the licensed racetrack facilities started strong when operations began, but all have had a varying rate of success throughout the years. A gradual downward trend has continued to date for the live track handle and simulcast export at the racetracks in the state. Simulcast import wagering had its highest handles in Iowa in the early 1990's. Following this period of time, simulcast import wagering began a downward trend which continues to date.

Potential Revenue Impact. Revenues from exchange wagering are generated in a different manner than traditional pari-mutuel wagering. With exchange wagering, a commission is charged on either the net winnings or bet winnings of the customer depending on how the operator or jurisdiction elects to charge a customer. A net winnings model, where a commission is charged on the customers' overall winnings from the market or pool, encourages greater liquidity for the exchange, however would likely generate lower overall revenues compared to a bet winnings model where commissions are charged on each winning wager within the race. There is debate in the industry whether exchange wagering will grow overall wagering revenues. Some people in the industry believe the commissions charged for exchange wagering are far less than the takeout of pari-mutuel wagers and that customers will shift their spending to these lower revenue generating exchange wagers, therefore the overall revenues generated for horse racing wagers will decline. Others in the industry believe exchange wagering will attract new

customers to horse racing, therefore any cannibalization of higher revenue generating wagers would be replaced and exceeded from this new customer base.

There is no precedent of exchange wagering in the United States to assist with projecting revenues in Iowa. In addition, the stakeholders interviewed for this report did not offer any opinions with respect to revenue projections. IRGC staff prepared a model, making a number of assumptions identified in the report, which demonstrates how revenues correlated to mutuel handle. The model may assist policymakers in understanding the different stakeholders that would receive revenues from exchange wagering and how much would reasonably flow to horse racing purses and track operator revenues in Iowa depending on the amount of handle received from exchange wagering. IRGC staff believes the model is a reasonable representation of what can be expected, however this representation should be considered for what it is; a representation based on a number of assumptions with no precedent to directly rely upon.

It is also unclear if Iowa will receive tax revenues as a result of adding exchange wagering to the wagering options at Prairie Meadows. Iowa Code 99D.15 currently calls for a tax of six percent on the gross sum wagered by the pari-mutuel method, and further allows for a tax credit of six percent if the gross sum wagered is below \$90 million in a year. Tax implications are unclear due to the following reasons: 1) revenue for exchange wagering is based on net or bet winnings and not gross sum wagered, 2) the belief that exchange wagering is different than pari-mutuel wagering, 3) it is difficult to project if enough wagering will occur for Prairie Meadows to exceed the \$90 million amount that allows for a credit of taxes paid. IRGC staff recommends if exchange wagering is authorized in Iowa, Iowa Code 99D.15 should be amended to clarify if or how exchange wagering would factor into the pari-mutuel tax.

Areas of consumer protection. One of the strongest ways IRGC protects the public and game integrity is to license all companies and their key employees. IRGC gathers information from investigators and other regulators to thoroughly investigate and inspect all parties. This process would ensure a company is compliant, financially viable, and has ample capital to run the exchange with the utmost standards and quality.

IRGC has previously worked with industry participants to develop uniform standards that relate to the prevention of problem gaming. Prevention of underage gambling, as well as the ability for problem gamblers to limit or withdraw themselves from gaming activity, is included in these standards. Research has indicated in an online environment, many companies do have technology that can help in age and personal identification. IRGC should require the exchange operator have software in place to ensure the exchange functions as designed, in regards to determining age and personal identification of people wagering on the exchange.

Wagering via the internet does bring to the forefront concerns regarding identity theft, financial account security, and money laundering. IRGC has contracted with GLI and BMM in the past to provide independent testing and verification of various software and hardware components involved with slot machine and table game operations. IRGC should again utilize GLI, BMM, or other independent companies to ensure the exchange operator has quality control processes and products in place that can detect the aforementioned activity and limit it or stop it completely.

A unique aspect of exchange wagering and subsequent concern of the public is the potential of cheating in a race. Lay betting is a new idea and an integral part of exchange wagering. How can the public be confident that a horse and its rider ran at their best possible

effort? One potential way to address this concern is to limit who can place lay bets. The regulatory authority can make rules prohibiting any licensee who has a direct connection to a horse from making lay wagers. A review of regulatory rules in California and New Jersey show a consensus that a list of licensees that could be restricted from making lay wagers include: jockey or rider of a horse, trainer/assistant trainer, veterinarian, valet or stable employee, owner of horse, or anyone directly associated with these groups whom may have knowledge of a horse's condition that isn't known to the public. This specific concern is equivalent to insider trading in the stock exchange.

Another aspect of exchange wagering is allowing in-play wagering, or making wagers after the start of a race and before the race has been declared official. This option allows bettors the opportunity to hedge previous bets based on real-time information at new market odds that are updated continuously. IRGC staff research has noted a series of questions concerning in-play wagering. If the video signal is delayed for any reason, how could this impact the betting public? Could someone intentionally or even unintentionally gain an advantage in placing wagers and getting more favorable odds versus any other bettor who is viewing the same race but at different signal strength or with a time delay? In these types of scenarios, does the regulatory body allow winning wagers to be paid out or does the regulator void the race and return all initial wagers? How are complaints handled from the public? An additional point of review could be the use of gambling bots. Gambling bots are software which can be used on the gambling exchange to help speed up the process of evaluating information and placing subsequent wagers.

Future Research Suggestions. The research conducted by IRGC staff revealed some areas where information was difficult to obtain or seemed to be contradictory. Specifically,

IRGC discovered conflicting answers as to how much or which segments of the horse racing industry will benefit from exchange wagering. This is best demonstrated by the varying positions of policy makers in the two states where exchange wagering is legal in the United States, California, and New Jersey. It should also be noted the revenue projections used in this report included a number of assumptions in an effort to provide some guideline for how increased handle translates to income. It would be beneficial to further study these assumptions along with receiving additional information on the topic of revenue.

Further information concerning in-play wagering and automated wagering software may also be needed because both are common in exchange wagering. In-play wagering produces additional wagering opportunities for customers that are not offered in traditional pari-mutuel wagering. These wagers may generate additional interest and revenue; however it is possible to gain an advantage viewing races live versus having some delay via a simulcast link. Automated wagering software is something that is encouraged in exchange wagering to keep pools liquid. This is something that appears to be common in stock and commodity trading and could bring high interest and revenues for those not currently participating in pari-mutuel wagering. Additional thought and research may be needed to understand how automated software interacts with the exchange wagering system to ensure all customers are receiving similar access.

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Appendix A

Consent Form

Report Title: Request pursuant to SF 438, (framework for the state regulation of exchange wagering)

Surveyor: Iowa Racing and Gaming Commission (IRGC)

What is the purpose of this survey?

The purpose of this survey is to gather information from pari-mutual players of licensed Iowa racetracks regarding potential betting via wagering exchanges. The data gathered in this survey, along with other data, will be utilized by the IRGC to assist in preparing a report to the general assembly regarding the creation of a framework for the state regulation of exchange wagering in Iowa. The report will be completed by December 01, 2015, and will be posted on the IRGC website.

What will I do in this survey?

If you consent to take this survey, you will complete the questionnaire and return it to the IRGC via its designee. All answers will be anonymous. All questions should be answered so as to help the IRGC in utilizing the results in this study.

How long will it take me to complete this questionnaire?

The survey will take approximately 5-10 minutes to complete. There is no advance preparation needed.

What are the benefits of participating in the survey?

The benefits to participating in the study are that the participants will be assisting the IRGC in learning about exchange wagering in order to prepare a report for the general assembly.

Will I receive any compensation for participation in this study?

There is no monetary compensation or fee to be paid to any participant in this study. Participation is completely voluntary.

Who can I contact for information about this survey?

For more information about the survey, you can contact the IRGC at (515)281-7352.

Completing the survey implies my consent to participate in this research.

Thank you for your participation!



Exchange Wagering Questionnaire

Introduction: What is exchange wagering and how does it differ from pari-mutuel wagering?

Pari-mutuel wagering in Iowa is a betting system that creates a pool of money based on possible winning outcomes at a race track. The track takes a minimal fee out of the pool and the remainder is paid to all winners. In comparison, exchange wagering is person-to-person betting. One person offers their own price for a given event and another person can decide to accept it. The exchange operator takes a percentage from each winning wager. In many ways, an exchange is similar to the stock market and offers options that standard pari-mutuel wagering doesn't. Bettors can wager on both winning and losing outcomes in the same race. This may allow the bettor to hedge their bets.

For example a participant can place a bet at established odds on a winning outcome (called a back bet). This individual then waits for another individual to take the bet. The person taking this bet in effect becomes the bookmaker and bets against the winning outcome (called a lay bet). A betting exchange may also allow bettors to buy, sell, or trade existing wagers up to the time of the gambling event being completed. *For the purposes of this survey, exchange betting would be an Internet site on which two participants could place a wager against one another on the outcome of a race that is conducted at a pari-mutuel racing facility.*

Survey Questions for Potential Exchange Wagering in Iowa

- 1) Does the idea of wagering person-to-person on a horse or dog race appeal to you?
 Yes
 No
 Somewhat

- 2) Have you ever participated in exchange wagering?
 Yes
 No

- 3) How often do you participate in the current forms of pari-mutuel wagering at a race track?
 Never
 A few times a year
 A few times a month

- A few times a week
- More than 4 times a week

4) What aspects of pari-mutuel horse racing do you enjoy? (Choose all that apply)

- Watching the races
- Being able to wager varied amounts
- Being able to place different types of wagers
- The social aspect of attending the races
- Watching and wagering on simulcast racing

5) If exchange wagering becomes legalized in Iowa, how often would you wager? (Choose only 1)

- Never
- A few times a year
- A few times a month
- A few times a week
- More than 4 times a week

6) What concerns do you have for exchange wagering as it relates to pari-mutuel wagering?
(Choose up to 3)

- Confusion of how to set up account and place wagers
- How to "cash out" or receive funds from winning wagers
- How to ensure integrity as it relates to the "laying" wagers (betting to lose)
- What regulatory oversight is there regarding the operator(s) of the wagering exchange
- New way of wagering will cannibalize funds from existing traditional bets
- Loss of connectivity during races
- Concerns about legality
- Confusing rules
- Other: _____

7) What do you view the pros to be for exchange wagering as it relates to pari-mutuel wagering?
(Choose up to 3)

- Ability to set prices on bets
- Ability to place either "back" or "lay" bets
- Ability to trade wagers in the exchange after initial wager has been placed
- New form of wagering will increase total revenues
- Will provide for additional interest in racing from betting public that wasn't there before

8) The following regulatory measure is the most important to me (Choose only 1)

- Protection of funds
- Race integrity
- Prevention of underage gambling

- Prevention of problem gambling from “addicted” or “susceptible” patrons
- Protecting confidential personal information
- Wagering integrity and audit trail in the event of a dispute and investigation
- Other: _____

9) I would utilize exchange wagering more frequently if (Choose only 1)

- I could participate in an online environment
- Legislation is passed that specifically addresses the legalization
- I will not wager via a betting exchange

10) If exchange wagering is legalized in Iowa, I would (Choose only 1)

- Visit the racetrack less often to wager on live racing
- Visit the racetrack more often to wager on live racing
- Visit the racetrack the same amount of time

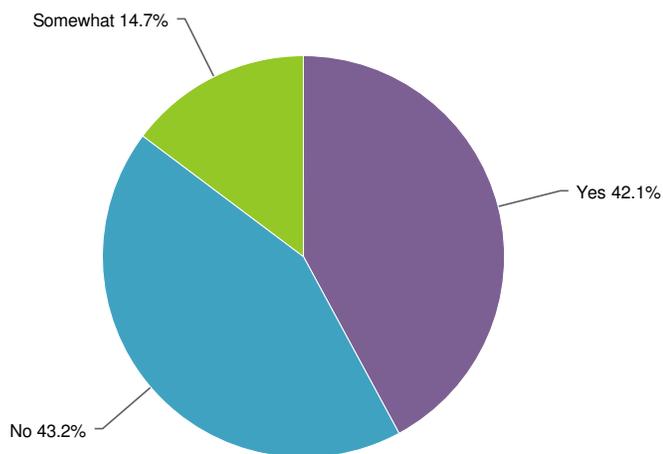
11) If exchange wagering is legalized in Iowa, my wagering budget will (Choose only 1)

- Pari-mutuel budget will increase; exchange budget will increase
- Pari-mutuel budget will decrease; exchange budget will increase
- Pari-mutuel budget stay the same; exchange budget will increase
- Pari-mutuel budget stay the same; will not wager on exchange

Appendix B

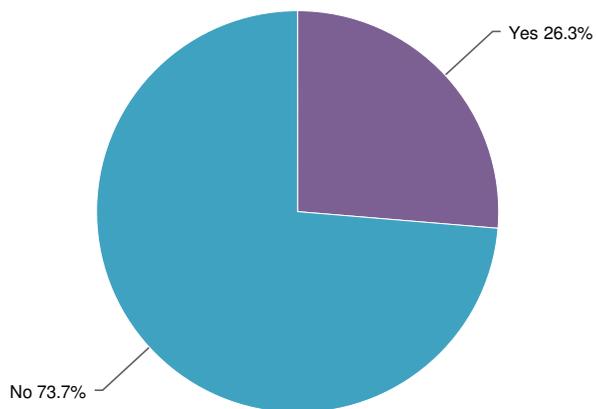
New Summary Report - 21 August 2015

1. Does the idea of wagering person-to-person on a horse or dog race appeal to you?



Yes	42.1%		40
No	43.2%		41
Somewhat	14.7%		14
Total			95

2. Have you ever participated in exchange wagering?

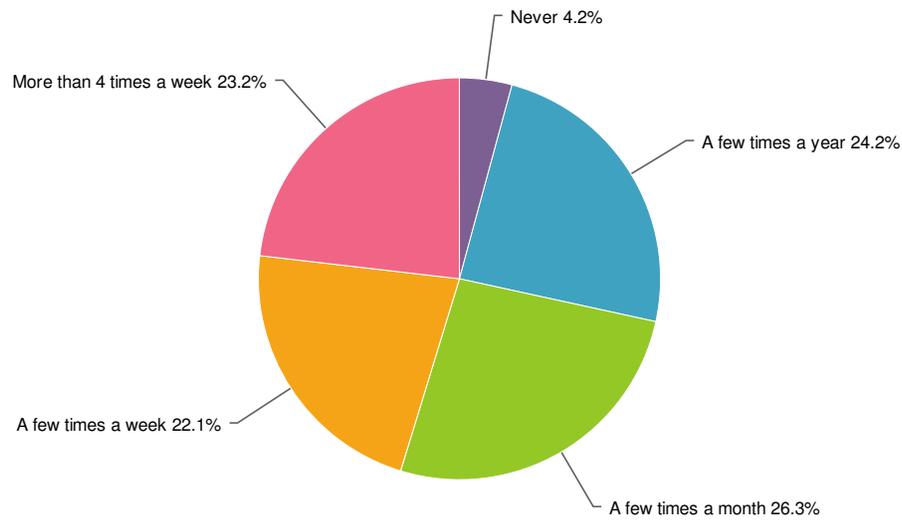


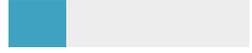
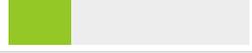
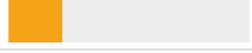
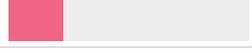
Total

95

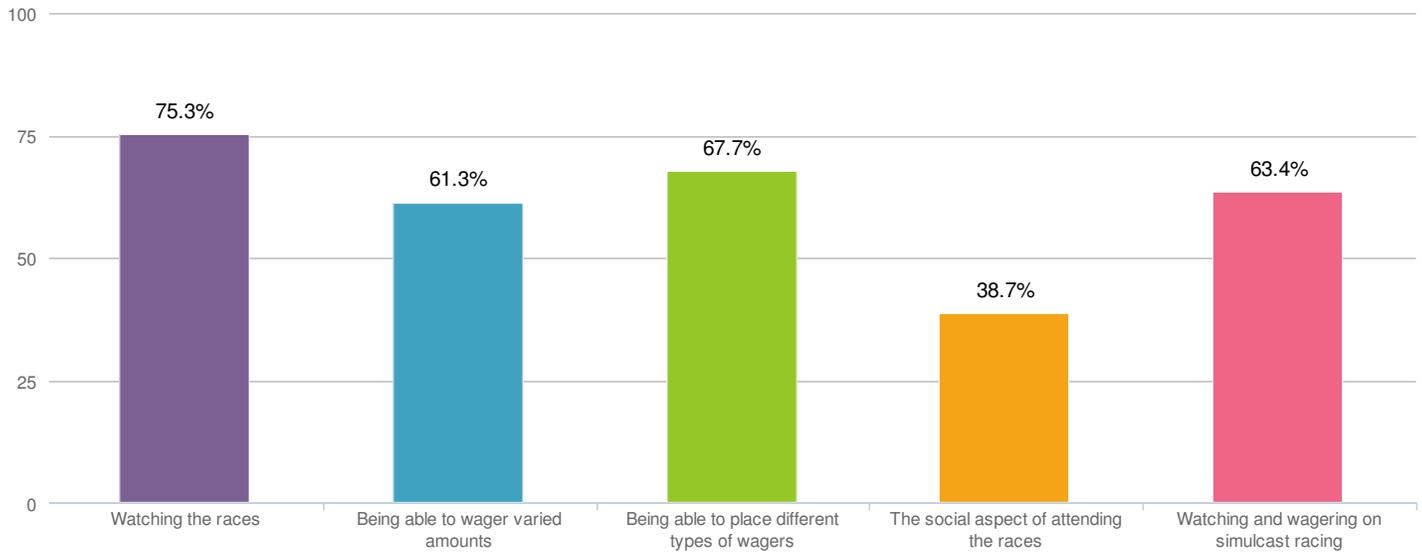
Yes	26.3%		25
No	73.7%		70
Total			95

3. How often do you participate in the current forms of pari-mutual wagering at a race track?



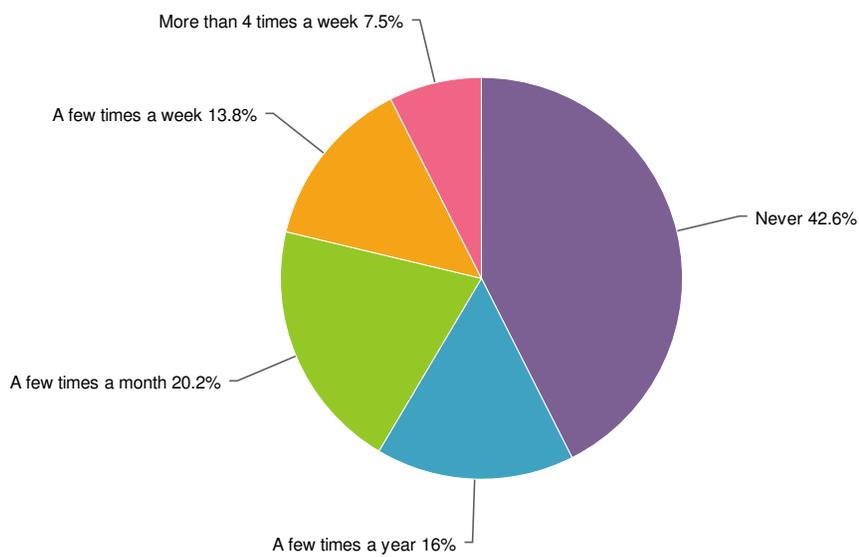
Never	4.2%		4
A few times a year	24.2%		23
A few times a month	26.3%		25
A few times a week	22.1%		21
More than 4 times a week	23.2%		22
Total			95

4. What aspects of pari-mutuel horse racing do you enjoy? (Choose all that apply)



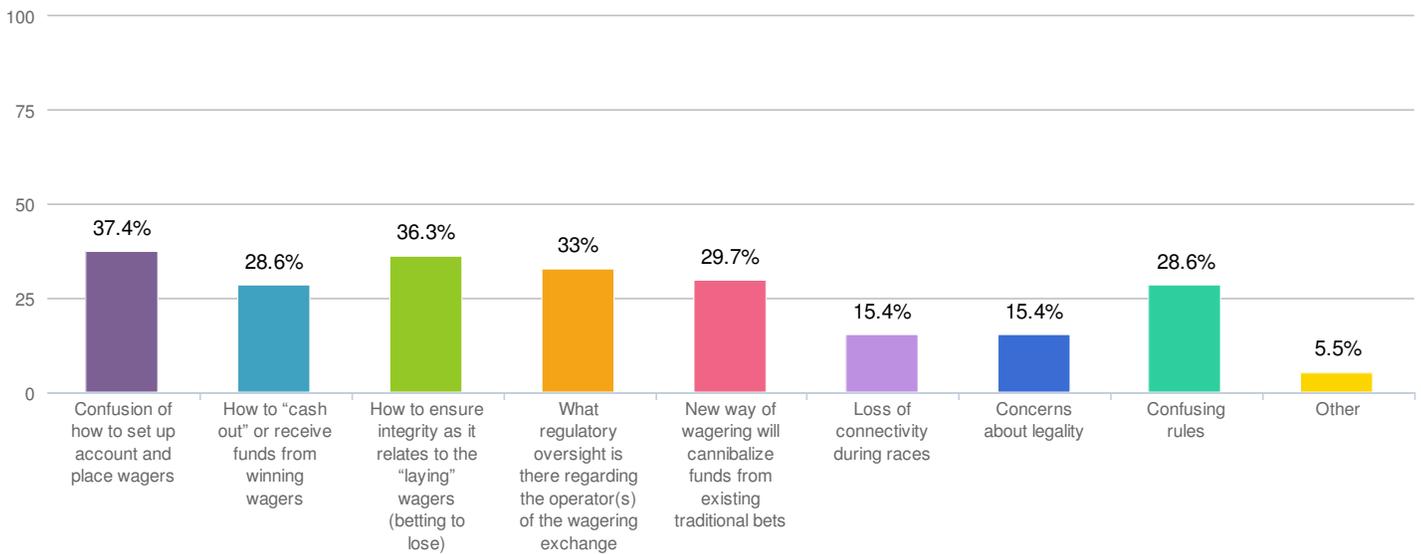
Watching the races	75.3%		70
Being able to wager varied amounts	61.3%		57
Being able to place different types of wagers	67.7%		63
The social aspect of attending the races	38.7%		36
Watching and wagering on simulcast racing	63.4%		59
Total			93

5. If exchange wagering becomes legalized in Iowa, how often would you wager? (Choose only 1)



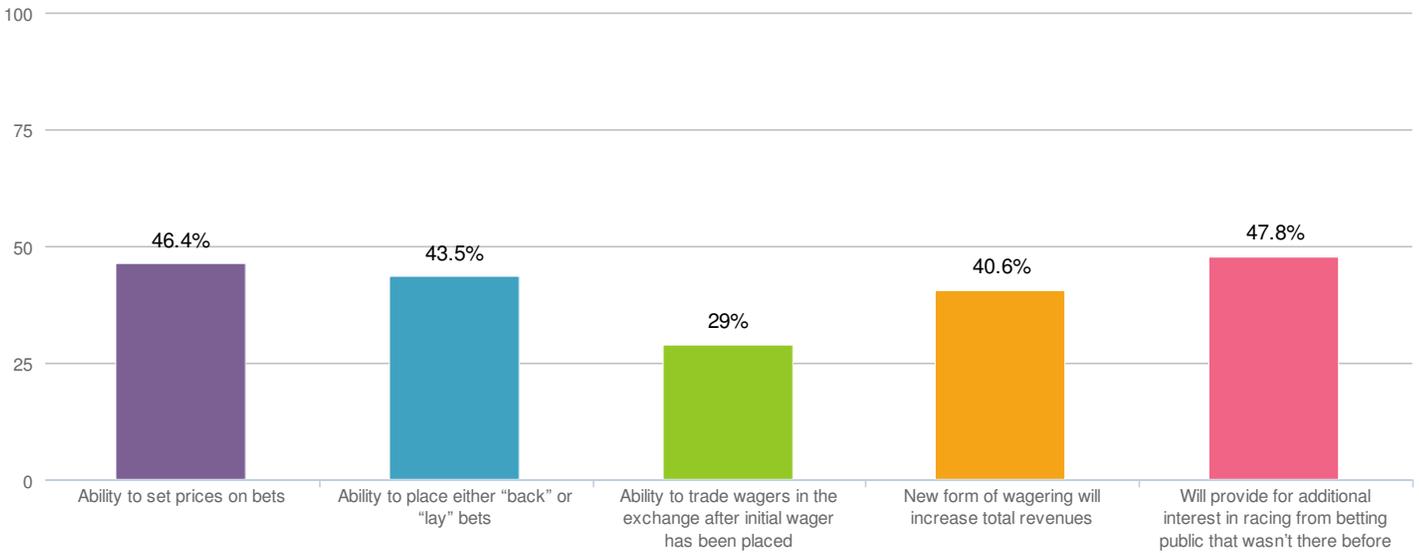
Never	42.6%		40
A few times a year	16.0%		15
A few times a month	20.2%		19
A few times a week	13.8%		13
More than 4 times a week	7.5%		7
Total			94

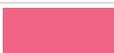
6. What concerns do you have for exchange wagering as it relates to pari-mutuel wagering? (Choose up to 3)



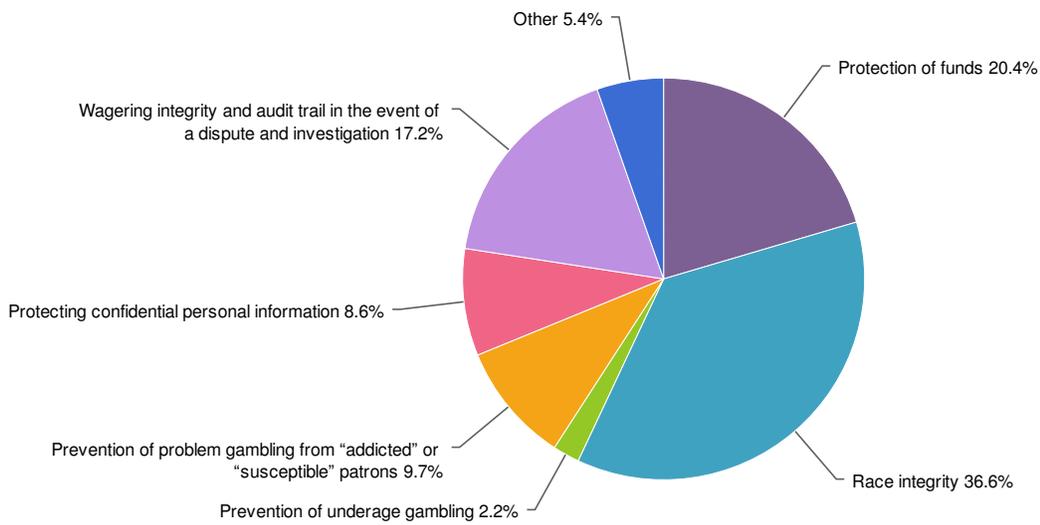
Confusion of how to set up account and place wagers	37.4%		34
How to "cash out" or receive funds from winning wagers	28.6%		26
How to ensure integrity as it relates to the "laying" wagers (betting to lose)	36.3%		33
What regulatory oversight is there regarding the operator(s) of the wagering exchange	33.0%		30
New way of wagering will cannibalize funds from existing traditional bets	29.7%		27
Loss of connectivity during races	15.4%		14
Concerns about legality	15.4%		14
Confusing rules	28.6%		26
Other	5.5%		5
Total			91

7. What do you view the pros to be for exchange wagering as it relates to pari-mutuel wagering? (Choose up to 3)

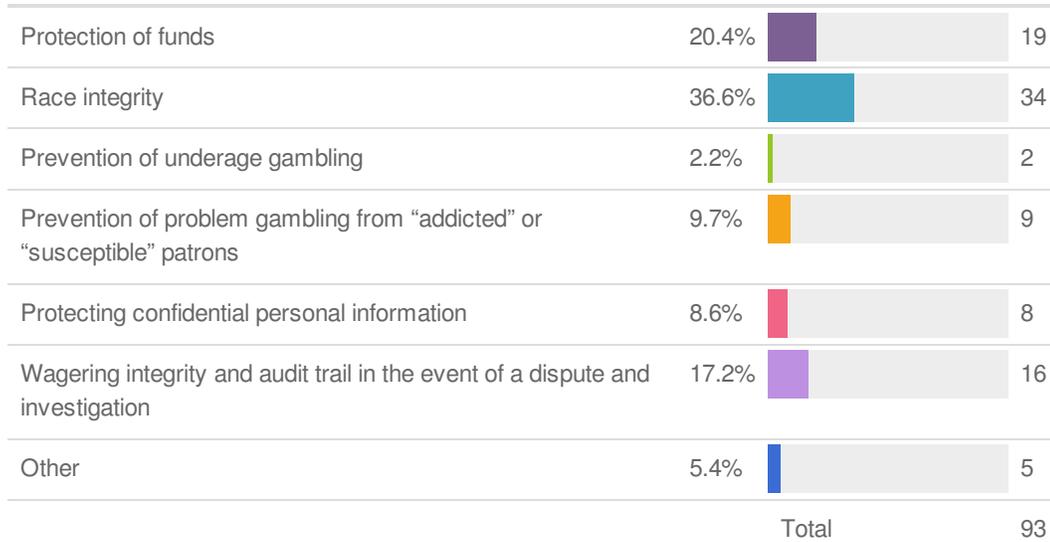


Ability to set prices on bets	46.4%		32
Ability to place either "back" or "lay" bets	43.5%		30
Ability to trade wagers in the exchange after initial wager has been placed	29.0%		20
New form of wagering will increase total revenues	40.6%		28
Will provide for additional interest in racing from betting public that wasn't there before	47.8%		33
Total			69

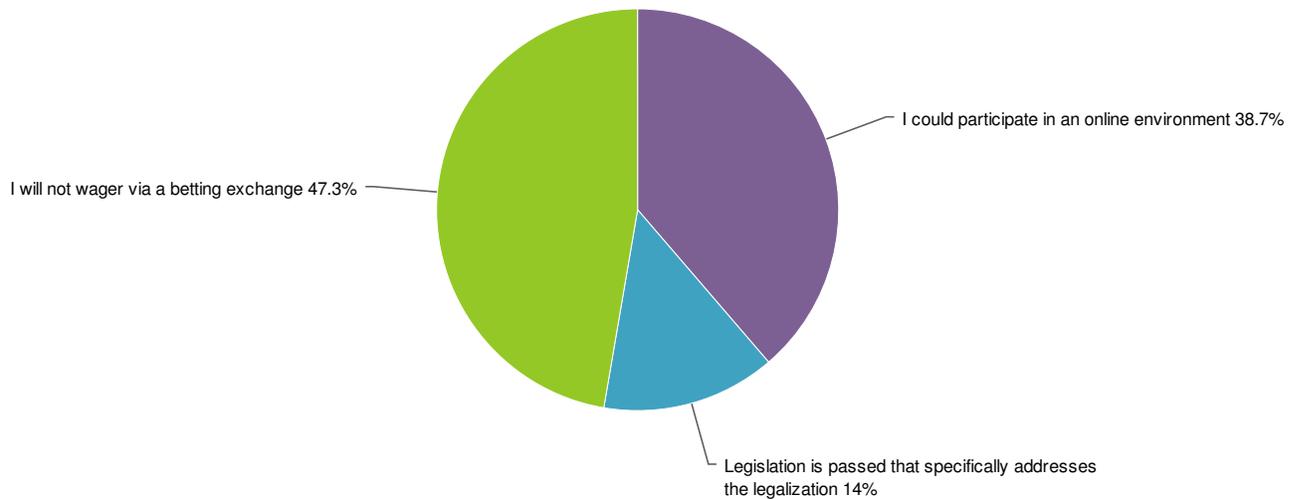
8. The following regulatory measure is the most important to me (Choose only 1)



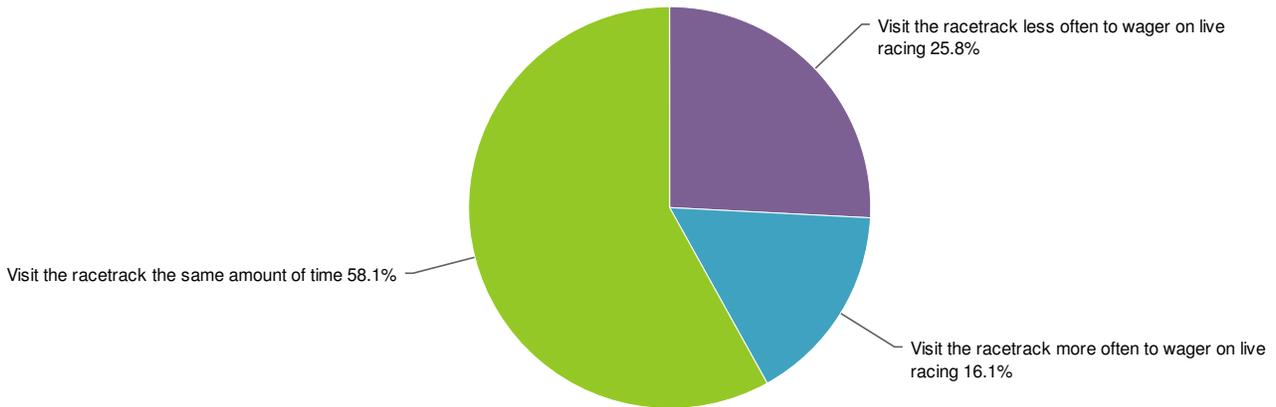
Total 93



9. I would utilize exchange wagering more frequently if (Choose only 1)

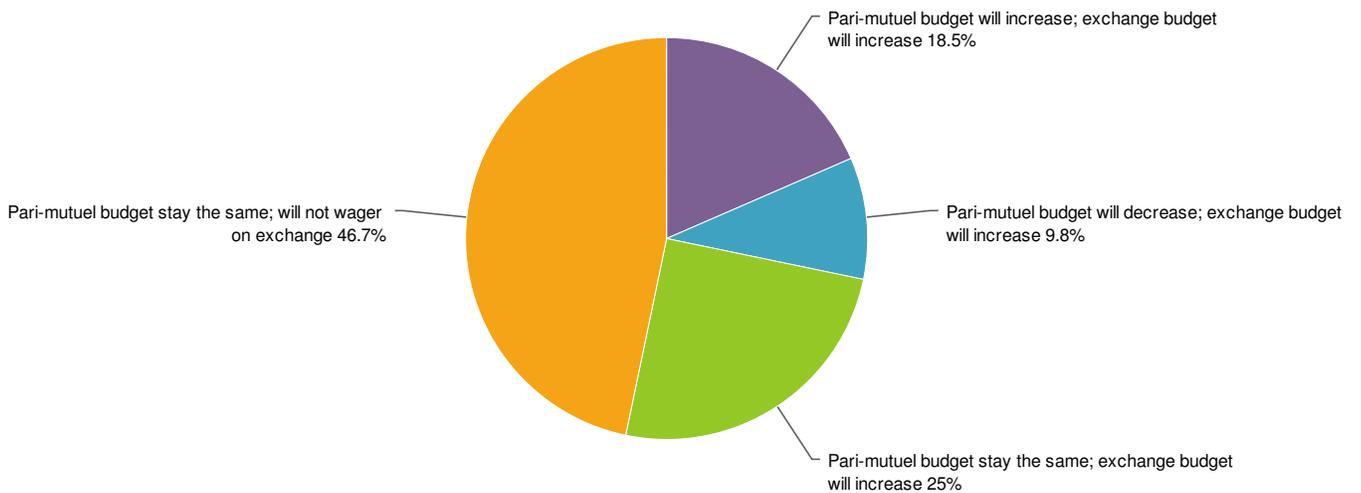


10. If exchange wagering is legalized in Iowa, I would (choose only 1)



Visit the racetrack less often to wager on live racing	25.8%		24
Visit the racetrack more often to wager on live racing	16.1%		15
Visit the racetrack the same amount of time	58.1%		54
Total			93

11. If exchange wagering is legalized in Iowa, my wagering budget will (Choose only 1)



Pari-mutuel budget will increase; exchange budget will increase	18.5%		17
Pari-mutuel budget will decrease; exchange budget will increase	9.8%		9
Total			92

