

I Questions raised by deputations

(1)(a) The Hong Kong Jockey Club (HKJC) has made an assessment of the illegal betting market on the basis of a combination of internal intelligence, consultancy input, commissioned survey and media reports. The analysis is summarized in the following paragraphs.

Illegal operators are increasingly offering a wide range of betting products in the market. In many police raids, the betting slips seized are a mix of bets on football, horse racing and sometimes Mark Six. It is therefore difficult to determine solely from betting slips and bank deposits the total amount of bets involved in a particular type of betting activity.

HKJC considers that the amount of bets seized in police raids fall far short of the actual size of the illegal betting markets. Such seizure figures could be a gross under-estimation, for the following reasons:

- Some raids take place during race time or match time while bookmakers are still taking bets. The amounts seized only reflect a portion of total betting turnover for the day and in some raids, the betting slips were known to have been destroyed.
- The amount seized by police in any particular raid is likely to reflect illegal bets taken on that day only and not illegal bets over the year. It is estimated that illegal bookmakers on average offer betting for some 200 – 250 days in a year;
- The amount seized in raids constitute only a small part of the unexplained deposits in the bank accounts of illegal bookmakers. Given that most illegal bookmakers offer credit betting, the actual betting turnover should be significantly greater than the amounts found in deposits;
- The likelihood of police raids involving football betting is higher as there are more football match days than horse racing days (over 200 vs 78); and

- It has to be assumed that police only successfully raid a proportion of all the illegal bookmakers as detection of such operations is difficult, given the heavy use of advanced communications and technology, especially mobile phones and the Internet, and the tendency for bookmakers to operate on a cross-border basis.

Over the past three years, the cash and betting slips seized by police during raids on illegal bookmakers amount to around \$152 million, which consist of a) horse racing: \$17 million; b) football betting: \$114 million and c) a mixture of both horse racing and football betting: \$21 million. Assuming there are 200 – 250 days of operation a year, this \$152 million in bets seized represent an average annual turnover of \$10 – 13 billion. However, this should reflect only the turnover for those illegal bookmakers actually arrested, and does not take into account the above factors accounting for the under-reporting of the total illegal betting markets.

There is also evidence that those who place bets with illegal bookmakers are more often those who place larger bets. This is illustrated through a police raid in January 2002 in which seizure of 30 betting slips on racing amounted to \$7.4 million. According to a survey commissioned by the Club in January 2005, it was found that 13% of horse race bettors also betted through illegal channels. Those bettors who bet through illegal channels reported betting larger amounts than those who did not.

Media reports from other Asian countries also show that illegal horse race betting in the region is a serious problem. While direct comparison is not possible due to differences in gambling policies and regulatory framework, the figures illustrate the percentage share of illegal horse race betting in the relevant gambling markets in the region:

- Japan: 38% (of the total market size)
- South Korea: 40%
- Singapore: 80%
- Malaysia: 92%

Given the underground and covert nature of illegal gambling, it is not possible to calculate precisely the size of the illegal market. However, taking into account all the above information and observations, the HKJC estimates that the illegal horse race betting market to be around \$50 – 60 billion each year.

- (1)(b)HKJC commissioned an independent economic research consultancy study on projection of the betting turnover and how to tackle the structural problems leading to the decline in betting turnover. The projection that, if these structural factors are not addressed, the turnover of authorized horse race betting would further decline to \$45 billion by 2008-09 is based on two major assumptions: 1) competition from illegal operators will continue to grow and 2), betting turnover would decline at a rate similar to that of the past five years during the next five years.
- (2) We consider that the analysis provided by the HKJC, which is supported by anecdotal evidence and other survey findings, provided a reasonable estimate of the existing size of illegal gambling markets.
- (3) We are currently combating illegal gambling through three measures—effective anti-gambling legislation, vigorous law enforcement and proper regulation of authorized gambling activities.

The existing betting duty system and regulatory regime on horse race betting which had been in place since the 1970s have become inadequate for the purpose of effectively combating illegal gambling. We consider that the proposed betting duty reform, which provides greater flexibility for the licensed operator to set the take-out rates in respect of its betting products, would enhance its competitiveness vis-à-vis illegal bookmakers.

The proposed reforms to the betting duty system would continue to be supplemented by vigorous law enforcement and effective gambling legislation so as to combat illegal gambling effectively.

- (4) The HKJC's assessment of horse race betting turnover is based on a steady and significant decline starting from 1996-97. Although the economy improved in recent years, horse race betting turnover had not recovered, even in years (such as 2000-01 and 2003-04) which showed positive GDP growth, reflecting a structural decline problem. In this connection, the forecasts for future horse race betting turnover is based on the assumption that if no action is taken to address the structural problems facing horse race betting, the current downward trend will likely continue in the face of the growing challenge from illegal bookmakers.
- (5) According to HKJC, while the decline in betting turnover has been the result of a number of factors, it is largely due to certain structural reasons, in particular the growing illegal gambling market, which have led to a shrinking share of authorized horse race betting in the overall gambling market.

The economic downturn in recent years is one factor contributing to the decline in horse race betting turnover. However, even when the economy improved (GDP growth was positive in 2000-01 and 2003-04), horse racing turnover continued to decline. Economic downturn is therefore not considered to be a major factor leading to the decline of betting turnover.

While there might be some switch of betting money from horse racing to authorized football betting, this is not considered to be a major factor leading to the decline in turnover of authorized horse race betting since the betting turnover on horse racing had already declined by some 23% in the six years before the authorization of football betting in 2003. Furthermore, the rate of decline in horse race betting turnover before and after authorization of football betting was not notably different.

- (6) Illegal bookmakers and unauthorized offshore gambling operators are already offering betting services on horse racing and other sports throughout the year. Bettors are currently able to place bets on horse races all over the world at different times of a year owing to advances in communications technology and wider use of the

Internet. The proposed extension of the racing season mainly seeks to stem the current leakage of betting turnover to illegal and offshore bookmakers during the summer break.

Under the proposed regulatory regime for authorized horse race betting, underage and credit betting would be prohibited; promotional activities and materials of the licensee would not be allowed to target juveniles. The addition of racing days would not facilitate young people's participation in betting on horse races.

- (7) The major objective of the betting duty reform to horse race betting is to enhance the competitiveness of the licensed operator vis-à-vis illegal bookmakers so as to combat the illegal gambling activities more effectively. Increasing revenue is not a primary consideration.
- (8) The proposed reforms to the betting duty system seek to provide greater flexibility for the licensed operator to set take-out rates in response to changing market conditions. This should enhance HKJC's competitiveness vis-à-vis illegal bookmakers so as to divert the bets from illegal markets into authorized channels. The reform does not seek to encourage more people to gamble. There would be a series of safeguards under the proposed licensing conditions to minimize the negative impact of horse race betting on the community. These include prohibiting credit and underage betting; prohibiting promotional activities or materials of the licensed operators from targetting adolescents, misleading about the likelihood of winning or suggesting betting is a source of income or a viable way to overcome financial difficulties; as well as requiring the licensed operator to display warning messages against excessive gambling in its premises and on its website and provide information to bettors about services for problem and pathological gamblers.
- (9) We will conduct a review on the operation of authorized football betting shortly after the results of the study on Hong Kong people's participation in gambling activities are available. In evaluating authorized football betting, we would take into account all relevant factors such as the prevalence of illegal football gambling, the results

of police enforcement against illegal football gambling; and the prevalence of problem and pathological gambling.

In September 2003, the Government set up the Ping Wo Fund (the Fund) to finance preventive and remedial measures to address gambling-related problems. The HKJC contributed a total of \$25 million in the past two years and has undertaken to contribute \$12 – 15 million in the next three years. We would consider requesting HKJC to increase its contributions if there is a proven need to increase resources for the various measures.

- (10) As the licensing authority is vested in SHA, we consider the existing structure whereby the Commission could advise the SHA on the licensing and regulatory issue appropriate. This should also enhance the transparency and enable public participation in the regulation of the all major authorized betting activities.
- (11) The proposed regulatory regime of horse race betting would be similar to the existing regime for authorized football betting and lotteries. For example, the proposed licensing conditions would prohibit credit and underage betting, prohibit promotional activities or materials of the licensed operators from targetting adolescents, misleading about the likelihood of winning or suggesting betting as a source of income or a viable way to overcome financial difficulties. We do not propose to relax such restrictions which seek to minimize the negative impact of authorized horse race betting.
- (12) HKJC estimates that if the betting duty structure is reformed, it would be able to capture around 40% of the existing turnover of the illegal horse race betting market (increasingly dominated by illegal bookmakers concurrently offering a variety of other gambling activities), which is estimated to amount to around \$50-60 billion a year. It follows that the annual betting turnover of authorized horse race betting is estimated to gradually increase by around \$20 to 25 billion. Assuming that the annual betting turnover would increase to \$88 billion and the gross profit margin is 11% - 13% (the actual margins would vary among different bet types), the annual gross profit would be in the range of \$9.68 billion to \$11.44 billion, and

the betting duty revenue for the Government under the proposed progressive marginal betting duty structure would be \$7.02 billion to \$8.30 billion.

- (13) According to the HKJC, it is already one of the world's most efficient racing and betting operations. It has in recent years undertaken a series of strategic improvements and cost management programmes. As a result, its operating costs as a proportion of betting turnover have declined from 3.8% in 2002-2003 to 3.5% in 2003-04 and 3.2% in 2004-05. HKJC operating costs (as a proportion of the total turnover) are among the lowest in the world. Further savings in costs would not be able to address the underlying structural problems causing the continued decline in horse race betting turnover.
- (14) The proposed reforms seek primarily to enhance the competitiveness of the licensed operator vis-à-vis illegal bookmakers so as to combat illegal gambling activities. The increased flexibility in setting the take-out rates for different bet types would mainly serve to divert bets from the illegal gambling market to the authorized channel. The extended racing season seeks mainly to stem the current leakage of betting turnover to illegal or offshore bookmakers during the summer break. We therefore consider that the reform is unlikely to give rise to a substantial increase in public participation in horse race betting.
- (15) The HKJC, as an operator of authorized horse betting, is required to comply with the relevant legislation and conditions in the betting permit. In addition, the HKJC has its own internal codes of practice which regulate its operations. According to HKJC, it is widely recognized as a world leader in racing and has one of the most professional management teams in world racing. The HKJC is directed by a Board of Stewards, all of whom are elected, who provide their services without remuneration. Stewards are supported by a professional management team in pursuing a consistent policy towards achieving the HKJC's mission and vision. Racing controls are enforced through a team of highly experienced, internationally recognized stipendiary stewards who are among the strictest in the world. To further ensure the fairness and integrity of

racetracks, the HKJC operates one of the world's most advanced racing laboratories, applying stringent horse testing standards, and provide veterinary services which set international standards.

- (16) Under the proposed regulatory regime for horse race betting, the HKJC, as a licensed operator, shall abide by the licensing conditions and relevant laws. The licensing conditions of horse race betting would include a number of restrictions such as prohibition of underage and credit betting, and the promotional activities or materials should not target at juveniles. The SHA could also issue a code of practice to provide guidance on how the licensing conditions are to be complied with. The Football Betting and Lotteries Commission (to be renamed after the reform) would be tasked to advise SHA on issues relating to regulation of the conduct of horse race betting, including matters relating to contravention of licensing conditions on the part of the licensed operator. SHA could impose penalties on HKJC if the latter is found to have failed to comply with licensing conditions.

The HKJC shall also compile a return in respect of the calculation of betting duty payable and make duty payment in accordance with the Betting Duty Ordinance.

- (17) We will conduct a review three years after implementation of the new betting duty system to see if it produces desirable results and whether it should be continued.

II Questions raised by members

- (1) According to HKJC, while the decline in betting turnover has been the result of a number of factors, it is largely due to certain structural reasons, in particular the growing illegal gambling market, which have led to a shrinking share of authorized horse race betting in the overall gambling market.

While there might be some switch of betting money from horse racing to football betting, this is not considered to be a major factor

since the turnover of horse race betting had already declined by some 23% in the six years before the authorization of football betting in 2003. Furthermore, the rate of decline in horse race betting turnover before and after authorization of football betting was not notably different. The major objective of authorized football betting is to combat the growing problem of illegal football betting, its value estimated to be worth \$20-40 billion in the market. We do not consider that the structural decline in horse racing turnover is mainly due to the authorization of football betting.

- (2) The illegal bookmakers are aided by low operating cost and improved communications technology. As they are not required to run the horse races or pay betting duty to the Government, they have an inherent advantage over HKJC in offering more attractive odds to bettors, discounts on losing bets, short-term credit and other incentives. The proposed reforms seek to provide more flexibility to the licensed operator to adjust the take-out rates of its betting products in accordance with the changing market conditions. This would enhance HKJC's competitiveness vis-à-vis illegal operators as it would be able to offer better odds to make the discounts offered by the illegal bookmakers less attractive, and so reduce the incentives for bettors to bet through illegal channels. This, together with the integrity of the Club's operations, and public confidence in the HKJC, would divert a significant amount of illegal betting to the authorized channel.
- (3) As set out in our reply to question 14 raised by depositions, we do not consider that the proposed reforms would give rise to a significant increase in the public participation rate in horse race betting. Under the proposed licensing conditions for horse race betting, the licensed operator of horse race betting would not be allowed to accept bets from the underage, nor would it be permitted to target adolescents in its promotional activities. In this connection, the proposed reforms should not lead to a substantial increase in the participation rate in horse race betting among the underage.
- (4) According to HKJC, it continues to raise the quality of Hong Kong horses and HKJC races are widely recognized as among the best in

the world. HKJC accords very high priority to maintaining racing integrity and public confidence in the fairness of its races. The HKJC enforces the racing control through a team of highly experienced, internationally recognized stipendiary stewards who are among the strictest in the world. To further ensure the fairness and integrity of races, the HKJC also operates one of the world's most advanced racing laboratories, applying stringent horse testing standards, and provides veterinary services which sets international standards.

- (5) The betting duty reform proposals will give the HKJC more flexibility in setting the take-out rates for different bet types and adjust the odds in response to changing market conditions. This would enhance its competitiveness vis-à-vis illegal operators as it would be able to offer better odds which make the discounts offered by the illegal bookmakers less attractive, and so reduce the incentives for bettors to bet through illegal channels (the payout rates would vary among different bet types). This, together with the integrity of the Club's operation, and public confidence in the HKJC, would divert a significant amount of illegal bets into the authorized betting channel.
- (6) A number of overseas racing jurisdictions, including the UK, Singapore, and Victoria, Queensland, and New South Wales in Australia, levy betting duty on the basis of gross profits. Ireland is also reported to be considering a move to a gross profits tax for betting.

The UK Government changed from a general betting duty of 6.75% applied to all stakes to a gross profits tax of 15% in 2001. The main purpose of the reform was to make it possible for UK bookmakers to develop their domestic and international business from an onshore base, competing from a position of strength in the growing global market for telephone and Internet betting. Reports from the UK show that, following the change to a gross profits tax, general betting turnover increased and general betting duty, despite a decline immediately following the change in tax structure, also subsequently began to increase. UK Customs & Excise reported

that the initial decline in revenue was in line with estimates and that betting duty revenue should be back to pre-gross profits tax levels within 2-5 years, depending on the growth in betting turnover. A separate report, from the UK National Audit Office, indicated that the change in tax structure in the UK had also led to a significant reduction in illegal bookmakers.

In the Budget for 2005, the Minister of Finance of Singapore announced the change in horse racing betting duty from 12% on each bet to 25% on gross betting profits. The objective of the reform is to allow the Singapore Turf Club (the only authorized operator of horse race betting) to offer better odds and lower prices to their customers in order to compete more effectively with illegal gambling operators.

- (7) HKJC estimates that if the betting duty structure is reformed, it would be able to capture around 40% of the existing turnover of the illegal horse race betting market (increasingly dominated by illegal bookmakers concurrently offering a variety of other gambling activities), which is estimated to be about \$50-60 billion a year. The annual betting turnover of authorized horse race betting would increase gradually by around \$20 to 25 billion. Assuming that the annual betting turnover would increase to \$88 billion and the gross profit margin is 11% - 13% (the actual margins would vary among different bet types), the annual gross profit would be in the range of \$9.68 billion to \$11.44 billion, and the betting duty revenue for the Government under the proposed progressive marginal betting duty structure would be \$7.02 billion to \$8.30 billion.

Various scenarios have been developed as a basis for forecasting changes in betting turnover and betting duty revenue. However, there are inevitably many uncertainties involved, making it difficult to estimate accurately the level of betting duty after reform. In recognition of these uncertainties, and the associated risks, the HKJC agreed to make a guaranteed minimum payment to the Government of \$8 billion plus any duty from overseas bets in the first four years of the implementation of the reform. This is intended to ensure stable duty revenue from horse race betting during the initial years.

A review will be conducted three years after implementation to determine if the new duty system is producing desirable results and should be continued.

- (8) In terms of horse race betting and lottery turnover, approximately 81% is returned as winning dividends to bettors, 13% is paid to government as betting duty and profits tax, and 3% is used to fund the HKJC's operation, with the remainder going to the Lotteries Fund or charity allocations. The amount of charity donations made by HKJC in the last 10 years was about \$12 billion in total.
- (9) The Government is committed to providing a range of cultural and recreational activities to enrich the life of the general public. We would also continue to implement a series of preventive public education and publicity measures to raise public awareness of, and understanding of the risks and problems relating to gambling. This would help to prevent the public from indulging in gambling activities.