

# Regulatory Impact Statement

## Commission payments made by the New Zealand Racing Board to National Sports Organisations

### Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by Sport New Zealand (Sport NZ) and provides an analysis of options for improving the effectiveness of commission payments made by the New Zealand Racing Board (NZRB) to National Sports Organisations (NSOs).

*Sport sector should continue to benefit from sports betting*

A key assumption is that the sport sector, and NSOs in particular, should continue to benefit from revenue the NZRB generates through betting on sport. We did not consider any change to the current principle within the Racing Act 2003 (Racing Act) whereby the relevant NSOs receives a proportion of the NZRB's revenue generated through betting on the relevant sport (whether the sport event is within the jurisdiction of the NSO or not). We have also assumed that this arrangement should continue to be set out in legislation or regulation. We have assumed this is necessary because the NZRB's statutory objectives incentivise it to maximise betting profits for the long term benefit of the racing industry, as opposed to NSOs.

*Benefits of sports betting should be split more equitably between the racing and sports sectors*

We have also assumed that the racing industry should continue to derive some benefit from sport betting in recognition of the historic and ongoing investment in betting infrastructure, marketing and intellectual property (via the TAB). This assumption is consistent with the NZRB's statutory objectives, which include maximising its profits for the long term benefit of New Zealand racing. We have therefore also assumed that the benefits of sports betting should be shared in an equitable fashion between the sporting and racing sectors.

A key assumption is that an "equitable" sharing of benefits is one that, over time, provides a more equal share of revenue (in terms of net betting revenue) between the racing and sport sectors. Any suggestion that the sport sector should receive a very large proportion (or all) of sports betting revenue could represent a significant departure from the NZRB's statutory objectives and is therefore beyond the scope of the options considered in this paper.

*NZRB will undertake significant investment to improve its performance*

The NZRB has estimated that an investment of approximately \$60-\$75 million over three years is required to improve its performance and profitability. Improved performance and profitability should lead to an increase in distributions to sport and racing.

*The racing and sport sectors benefit from the long-term sustainability of the NZRB*

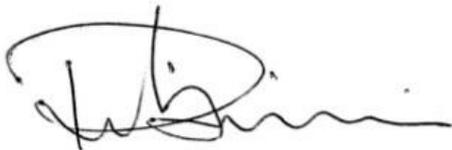
The NZRB's key objective is to maximise its profits for the long-term benefit of New Zealand racing. However, as noted above, the NZRB also provides a proportion of its sports betting revenue to NSOs. The returns provided to the racing and sport sectors are therefore dependant on the performance and profitability of the NZR. Ultimately, the racing and sports sectors benefit from the long-term sustainability and profitability of the NZRB's operations.

*Limitations on analysis*

A significant limitation of our analysis is that the figures used to assess the impact of changes to the formula in section 57(1)(d) of the Racing Act are based on projections of the NZRB's future sports betting revenue. These projections are based on forecasts made in the NZRB's Statement of Intent 2016-18, which is available on the NZRB's website. As such, the exact impact of any changes will not be known until NZRB's sports betting revenue is known.

*Timing of proposed amendments to the Racing Act*

Given any change to the formula in section 57(1)(d) will require a legislative amendment, the options discussed in this paper have been designed so that they can be included in the Racing Act Amendment Bill that will be required to implement the proposals of the Offshore Racing and Sports Betting Working Group (assuming those proposals go ahead). Amending the formula in section 57(1)(d) via a stand-alone Bill is not considered a viable option given such a minor amendment may not be progressed in the absence of other changes to the Racing Act.



Peter Miskimmin  
Chief Executive  
Date:

## Executive summary

1. This paper provides an analysis of options for improving the effectiveness of commission payments made by the NZRB to NSOs.
2. The NZRB is established under the Racing Act as the only New Zealand-based provider of racing and sports betting via the TAB (the NZRB's betting brand). The NZRB's primary function is to support the New Zealand racing sector. As such, revenue the NZRB generates through racing and sports betting is used to support the racing industry.
3. However, a certain proportion of sports betting revenue is also provided to NSOs. The amount of revenue provided to NSOs is governed by a formula set out in section 57(1)(d) of the Racing Act. This paper proposes amendments to that formula to achieve the following objectives:
  - improve the NZRB's financial position and competitiveness by moving away from a formula based on turnover. This recognises that the NZRB competes in a global betting market
  - ensure a more equitable distribution of benefits between the racing and sport sectors
  - ensure that total commission payments to NSOs increase (relative to the 2016 financial year)
  - allow the wider sport sector to receive some benefit from the payments made by the NZRB to the sport sector
  - allow greater flexibility to change the formula
4. Ultimately, the funding received by the racing and sports sectors from the NZRB is dependent upon the profitability and sustainability of the NZRB's operations. Any reforms that enhance the NZRB's operations will benefit the racing and sports sectors in the long term.
5. This paper recommends the current formula in section 57(1)(d) of the Racing Act be replaced with a formula that provides:
  - A minimum of 23 percent of Net Betting Revenue (NBR) provided to the relevant NSO; and
  - 3 percent of total NBR provided to the wider sport sector via Sport NZ (initially set at 2 percent, rising to 3 percent in the second year and subsequent years)
6. We also recommend this formula is set out in regulations made under the Racing Act. Setting out the formula in regulation provides a greater degree of flexibility to amend the formula in response to any significant changes in the NZRB's operations.
7. It is important to note that the proposed formula sets out the *minimum* amount received by NSOs. NSOs would retain the ability to negotiate more than the minimum payment.

## Status quo and problem definition

### **Background**

#### *Regulation of gambling*

8. Gambling in New Zealand is regulated under the Gambling Act 2003 (Gambling Act) and the Racing Act 2003 (Racing Act). Both Acts are characterised by the imposition of restrictions on betting operators and the requirement to distribute profits to the community.
9. Generally speaking, gambling is unlawful unless it is authorised by the Gambling Act or the Racing Act. The New Zealand Racing Board (NZRB) and Lotto NZ are the only New Zealand-based gambling providers that are allowed to operate online gambling in their respective areas (ie, lotteries and betting). The provision of other online gambling activities (eg, poker, gaming, casino-style games) by New Zealand-based operators is prohibited.
10. However, gambling through overseas betting operators (primarily online) is not prohibited under either the Gambling Act or the Racing Act. As such, New Zealanders are free to bet through online betting operators that are based overseas.
11. Overseas gambling operators are prohibited from advertising their products and services in New Zealand and from having a physical presence in New Zealand, eg operating betting outlets in New Zealand.

#### *The NZRB has a statutory monopoly on racing and sports betting*

12. The NZRB is the only New Zealand-based provider of racing and sports betting via the TAB (the NZRB's betting brand). This model aligns with the purposes of the Gambling Act in ensuring the benefits of betting are directed back to the racing and sports sectors. The racing industry benefits through the distribution of net profits through the three racing codes, which are subsequently paid to participants in the industry in the form of stakes as well as supporting infrastructure. Stakes money is the primary avenue by which owners, trainers, jockeys/drivers etc generate income from racing. The sport sector benefits through commission payments to NSOs.
13. The NZRB is a statutory body established under the Racing Act. Under the Racing Act, the objectives of the NZRB are to:
  - promote the racing industry
  - facilitate and promote racing betting and sports betting
  - maximise its profits for the long-term benefit of New Zealand racing
14. The NZRB's gross betting revenue (from all forms of betting) for 2015/16 was \$342.3 million, consisting of \$294.1 million derived from betting on racing and \$48.2 million derived from betting on sport. In 2015/16, the NZRB's turnover from all forms of betting was \$2.27 billion.

#### *The Offshore Racing and Sports Betting Working Group*

15. In 2015, the Minister for Racing commissioned an Offshore Racing and Sports Betting Working Group (the Working Group), to consider the impact of offshore gambling on the New Zealand racing and sports sectors.

16. The Working Group did not consider possible changes to the formula in section 57(1)(d) of the Racing Act.
17. The Working Group made a number of recommendations aimed at reducing the competitive disadvantage that the NZRB faces in comparison to offshore operators. The key recommendation related to the introduction of legislation with explicit extraterritorial intent to require all offshore gambling operators to:
- pay to use New Zealand racing and sports information in their betting products; and
  - pay when they take bets from New Zealand residents, regardless of whether the bet is on a New Zealand event or an international one.
18. The Department of Internal Affairs has produced a Regulatory Impact Statement (RIS) on the Working Group's proposals.
19. An amendment to the Racing Act would be required to implement some of the Working Group's recommendations. Amendments to the formula in section 57(1)(d) of the Racing Act could be included in the Racing Act Amendment Bill that implements the Working Group's proposals (assuming those proposals go ahead).

#### *Definition of key financial terms*

20. The following key financial terms are used throughout this paper:

- Turnover: the value of bets placed
- Gross betting revenue (GBR): turnover minus dividends paid (winnings to customers)
- Net betting revenue (NBR): gross betting revenue minus certain government related charges (duty, GST and Problem Gambling Levy)
- Profit: net betting revenue minus the NZRB's operating costs

#### **Status quo**

##### *The NZRB's sports betting business*

21. Under the Racing Act, the NZRB cannot conduct betting on any sport or sporting event without the written agreement of the relevant NSO.<sup>1</sup> A written agreement must set out the revenue the NSO will receive from betting conducted involving its sport, including matches that take place overseas and which may not include New Zealand teams.<sup>2</sup> These payments are known as commission payments. The written agreement is also the primary mechanism by which NSOs can regulate betting on their respective sport, for example by preventing the NZRB from offering certain types of bets on its sport.
22. The rationale embedded in the Racing Act is that in return for the statutory monopoly granted to it the NZRB must use the funds it generates to support the racing and sport sector. Commission payments to NSOs are the primary way in which the NZRB supports the sports sector. The NZRB also contributes funding to the sports community through class 4 gambling funds.

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<sup>1</sup> Section 55(1) Racing Act 2003.

<sup>2</sup> Section 55(2) Racing Act 2003.

23. The Racing Act sets the formula for determining the minimum commission payment the NZRB must provide to an NSO. The NZRB must provide the relevant NSO with at least:<sup>3</sup>
- five percent of totalisator sports betting *turnover* (a form of betting where bets are placed together and payoff odds are calculated by sharing the betting pool); and
  - one percent of fixed-odds sports betting *turnover* and five percent of *gross profit* (turnover minus dividends paid) from fixed-odd sports betting.

24. It is important to note that currently all sports betting is fixed odds betting.

25. Currently, the racing sector receives a greater share of the benefits derived from sports betting than the sport sector. In 2015/16, the NZRB provided \$8 million to NSOs through commission payments. The remainder of the NZRB's profits generated through sports betting were used to support the racing industry, estimated by the NZRB to be \$9 million.

26. The formula in section 57(1)(d) is the minimum amount and NSOs can seek to negotiate a higher commission payment from the NZRB. However, we understand the usual practice is for the NZRB to offer the minimum amount to NSOs. This occurs because one of the NZRB's statutory objectives is "to maximise its profits for the long-term benefit of New Zealand racing". As such, the NZRB will only offer more than the minimum where doing so will produce a commercial outcome that will ultimately benefit the racing industry. Put in another way, the NZRB's statutory objectives incentivise it to maximise betting profits for the long term benefit of the racing industry, as opposed to NSOs.

*Sports betting is now a significant part of the NZRB's business*

27. While racing is still the NZRB's core business, betting on sport is growing rapidly both nominally and as a percentage of NZRB business. For example, sports betting turnover has increased from \$114 million in 2003 to \$554.8 million in 2016. This trend is expected to continue.

	FY03	FY12	FY13	FY14	FY15	FY16
Sport Turnover (\$m)	\$114.4m	\$245.7m	\$246.1	\$315.9m	\$405.1m	\$554.8m
Percentage of Total Betting Turnover	10%	15%	14%	17%	20%	24%

28. It took nine years for sport turnover to double from 2003. At the end of the current financial year, it will have doubled again in less than half the time.

*Declining gross betting margin and the growing importance of in-play sports betting*

29. While sports betting is growing as a proportion of the NZRB's business, it is critical to recognise that increases in turnover have not equated to corresponding increases in gross betting revenue. In fact, gross betting margin from sports betting is declining. This is due to the growing and substantial impact of in-play betting (i.e. betting on live options during a match). In-play betting is less profitable than other forms of betting for a number of reasons. This is primarily due to the lower number of options within each market and also the manual

<sup>3</sup> Section 57(1)(d) Racing Act 2003.

process NZRB employs to conduct fixed odds betting. The lower number of options within each market, the higher the probability of each option occurring, and therefore the lower the resulting margin. Further, the manual system limits the number of markets that can be offered, thereby restricting the overall number of options available to customers.

30. The graph below shows the growth in sports betting turnover broken into three segments: in-play, pre-play and multi. Over the past five years 60 percent of sports betting turnover growth has come from in-play options. In-play betting is currently 43 percent of total sports betting, with a three-year average margin of 5.1 percent. This compares to an average of 9.1 percent for pre-match and 21.7 percent for multi betting. Essentially, every \$1 of in-play is only worth \$0.60 of pre-match or \$0.25 of multi-betting turnover. Therefore, as in-play betting increases as a percentage of overall sports betting turnover, gross betting margin decreases, putting pressure on the profitability of in-play products. As a result, sport gross betting margin has decreased from 12.0 percent in 2012 to 8.7 percent in the 2016 financial year.

**Problem definition**

*The distribution of benefits from sports betting is not equitable between the racing and sport sectors*

31. The current formula in the Racing Act is inequitable because it has resulted in the racing sector receiving a greater proportion of the benefits of sports betting than the sports sector.

32. From 2012 to 2016, the overall benefit, in terms of Net Betting Revenue, received by the racing sector has been greater than that received by the sport sector. As the table below shows, the racing sector has received between 3 and 17 percent more than the sport sector between 2012 and 2016.

Share of net betting revenue: sport vs racing						
Year	2011	2012	2013	2014	2015	2016
Sport	17%	16%	17%	17%	19%	20%
Racing	17%	24%	23%	34%	28%	23%
Difference	0%	8%	6%	17%	9%	3%

33. As noted above, a key assumption underpinning the analysis in this paper is that an equitable distribution between the racing and sport sectors is one that, over time, provides an equal share of revenue (in terms of net betting revenue).

*The wider sport sector does not benefit from sports betting revenue*

34. Currently, the benefits of sports betting are only available to NSOs, not the wider sport sector. This occurs because section 55(2) of the Racing Act provides that commission payments must be paid to the relevant NSO. Put another way, the Racing Act does not allow the benefits of sports betting to be used to the benefit of the wider sport sector.

35. The wider sport sector includes, but is not limited to:

- NSOs – eg, NZ Cricket, NZ Rugby
- Regional Sports Trusts (RSTs) – eg, Sport Wellington, Sport Bay of Plenty
- Disability partners – eg, Halberg Disability Sport Foundation, Special Olympics NZ
- Education partners – eg, NZ Secondary Schools Sports Council, Physical Education NZ
- National Recreation Organisations – eg, NZ Recreation Association

36. While NSOs remain a crucial part of the New Zealand Sport sector, Sport NZ considers the impact of some of this growing source of funding from sports betting could be improved by allowing a proportion of it to be shared with the wider sector. NSOs focus their activities on their particular sport. However, the sport sector now covers a broader range of activities than it has been previously and the active recreation sector is becoming more important. Allowing some funding to be directed to a broader range of sports organisations would achieve a wider range of benefits.

37. Even amongst NSOs the funding from sports betting is not widely distributed. A small number of NSOs receive the vast majority of benefits generated through sports betting (10 NSOs receive around 95 percent of commission payments). While there are 71 NSOs that currently meet Sport NZ's investment criteria, the majority of these organisations do not receive funding from sports betting revenue.

*The emphasis on betting turnover is problematic for the NZRB*

38. The turnover component of the current formula is problematic for the NZRB for the following reasons:

- Commission payments based on turnover do not reflect the profitability of betting on a particular sport. This means that the NZRB has to pay commission payments even when it makes a loss on a particular event/match. This has a negative impact on the NZRB's financial position and ultimately its ability to compete with other sports betting agencies.
- The racing sector carries a disproportionate share of the sport betting risk/volatility associated with betting outcomes and long term margin trends resulting from shifting customer preferences (when compared to betting on racing). The current formula is heavily based on turnover (turnover accounts for over 66 percent of the total commission payment

with the remaining 33 percent made up of gross betting revenue). The turnover component of the formula is essentially risk-free for NSOs because the NZRB is required to pay the commission payment even when it makes a loss on a particular bet. In contrast, the payments made to the three racing codes are reflective of the profit the NZRB makes on bets, not simply the amount of money (turnover) bet.

- Racing carries all regulatory risk associated with GST, duty and the problem gambling levy. Turnover and gross betting revenue do not have GST, duty or the problem gambling levy deducted from them. This means commission payments made to NSOs are not affected by any changes in these fees/charges. Conversely, the payments made to the three racing codes are affected by these charges.
- It puts pressure on the sustainability of in-play betting (currently 43 percent of the sports betting book). The margin for in-play betting is lower than for other forms of betting. As in-play betting grows in proportion to the overall sports betting book it lowers the overall gross betting margin derived. Despite gross betting margin decreasing the NZRB is still required to make commission payments based on turnover; and
- The net effect of the above two points is that the incentives for racing and sport returns are not aligned and therefore focus sport stakeholder attention on turnover growth as opposed to margin performance. The NZRB advises that this generates confusion and prevents the collaboration needed to responsibly grow sport betting.

39. The NZRB has advised that if the formula was to remain unchanged, the long term sustainability of some products (eg, in-play sports betting) would come under substantial pressure. This would affect the NZRB competitiveness and ultimately the amount of money it has to return to the racing and sport sectors.

#### *The formula is difficult to change*

40. The Racing Act establishes the requirement that the NZRB must provide a certain amount of sports betting revenue to the relevant NSO. However, the Act also goes a step further and provides the formula that must be used to calculate the minimum payment to the relevant NSO.
41. In our view, this level of detail should not be contained in primary legislation. It is appropriate for the Act to include significant policy decisions, such as the decision that the relevant NSO should receive a proportion of sports betting revenue. However, including a detailed formula for calculating the proportion of sports betting revenue in primary legislation is not appropriate.
42. Including such detail in the Act makes it inflexible because it cannot be easily changed to respond to changes in the NZRB's betting operations. For example, primary legislation would have to be passed to respond to a significant change in betting patterns or the NZRB's profitability.
43. In our view, a greater degree of flexibility is required to respond to significant changes in the betting market and/or the NZRB's operations.

## Objectives

44. The objectives of the proposed formula change are to:

- Improve the NZRB's financial position and competitiveness by moving away from a formula based on turnover. This recognises that the NZRB competes in a global betting market
- Ensure a more equitable distribution of benefits between the racing and sport sectors
- Ensure that total commission payments to NSOs increase (relative to the 2016 financial year)
- Allow the wider sport sector to receive some benefit from the payments made by the NZRB to the sport sector
- Allow greater flexibility to change the formula

## Options and impact analysis

### ***Options for amending the formula to improve the NZRB's financial position and competitiveness***

*Option one: formula based on a percentage of Gross Betting Revenue (GBR)*

45. This option would entail replacing the current formula with a new formula based on a percentage of gross betting revenue.

46. Gross betting revenue is calculated by taking turnover (the value of bets placed) and subtracting dividends paid (winnings to customers). This option would help to improve the NZRB's financial position and competitiveness because commission payments would more closely reflect the profitability of bets placed. However, GBR does not take into account all of the costs incurred by the NZRB and therefore does not reflect the actual profitability of bets placed.

47. GBR does not take into account the following costs paid by the NZRB:

- Duty
- GST
- Problem Gambling Levy
- Operating costs

48. While a GBR-based formula is preferable to a formula based on turnover, it still presents difficulties for the NZRB because it does not reflect the actual profitability of bets placed or the costs incurred by the NZRB.

49. It is also important to note that by moving to a GBR-based formula some individual NSOs could receive reduced commission payments (relative to what they receive under the current formula). A reduced payment is likely for NSOs with commission payments that are based heavily on turnover (ie, where betting on that particular sport does not have a high level of profitability).

*Option two: formula based on a percentage of Net Betting Revenue (NBR) [preferred option]*

50. This option would entail replacing the current formula with a new formula based on a percentage of Net Betting Revenue.
51. Net betting revenue is calculated by taking turnover and subtracting the following costs:
- Dividends paid (winnings to customers)
  - Duty
  - GST
  - Problem Gambling Levy
52. The NZRB's operating costs are not subtracted from NBR.
53. In our view, a formula based on NBR appropriately balances the commercial realities of the NZBR's sports betting business, including its need to remain competitive in a global market, with the desire to ensure the sports sector continues to benefit from sports betting.
54. This option would benefit the NZRB because it would not be required to pay a commission payment on bets that result in a loss. In turn, this would allow the NZRB to continue to grow its in-play betting options and other products, which will ultimately improve its competitiveness and the returns it provides to sport.
55. As with the previous option, it is important to note that by moving to a NBR-based formula some individual NSOs could receive reduced commission payments (relative to what they receive under the current formula). This would occur for commission payments to NSOs where betting on that particular sport does not have a high level of profitability.

*Option three: formula based on a percentage of profit*

56. This option would entail replacing the current formula with a new formula based on a percentage of profit.
57. Profit is calculated by taking turnover and subtracting the following costs:
- Dividends paid (winnings to customers)
  - Duty
  - GST
  - Problem Gambling Levy
  - The NZRB's operating costs
58. This option would provide the NZRB with the greatest ability to improve its financial position and competitiveness because commission payments would directly reflect the profitability of bets placed. This option would also align incentives between the racing and sport sectors, for example through the sharing of risk and the overall return from betting.

59. This option would be administratively difficult to implement because it would require the legislation to set out a cost allocation model for sports betting. Detailing such a model in legislation would fundamentally alter the NZRB's operational settings and is not considered a viable option because reform to the NZRB's core operations and statutory objectives is beyond the scope of this paper.

*Option four: remove formula and rely on a contractual agreement between the NZRB and NSOs*

60. Under this option the formula in the Racing Act would be removed and not replaced. The requirement for the NZRB to have a sports betting agreement with the relevant NSO would remain.

61. This would essentially mean that the NZRB and the relevant NSO are free to negotiate and agree what, if any, benefit the NSO will receive from betting on its sport.

62. This option is not favoured for the following two reasons:

- The exact impact of this approach is difficult to predict given it would rely on each NSO reaching an agreement with the NZRB
- Despite the uncertainty mentioned above, it is very likely that total commission payments would decrease (relative to the 2016 financial year) because the NZRB's statutory objectives operate to incentivise it to maximise betting profits for the long term benefit of the racing industry, as opposed to NSOs.

### ***Options for ensuring a more equitable distribution of sports betting benefits between the racing and sport sectors***

63. This section sets out options for a new formula that will provide a more equitable distribution of benefits between the racing and sport sectors. As noted above, an equitable distribution is one that, over time, provides a more equal share of revenue (in terms of net betting revenue) between the racing and sports sectors.

64. We have set out below the different formulas that would provide an equitable distribution of benefits. These formulas are based on calculations undertaken by the NZRB. These calculations predict the value of the commission payments that would go to the sport sector (based on the formula option) and the estimated revenue that would be left over for use by the racing industry. Please note these calculations are based on projections of the NZRB's future sports betting revenue and are subject to a number of assumptions. These projections are based on forecasts made in the NZRB's Statement of Intent 2016-18.

- *Option one: 21 percent of Gross Betting Revenue (GBR) provided to sport sector*
- *Option two: 26 percent of Net Betting Revenue (NBR) provided to sport sector [preferred option given the analysis above]*
- *Option three: 54 percent of profit provided to sport sector*

- Options four: contractual agreement between NZRB and sports organisations. This option is not recommended because it would be very difficult to ensure an equitable distribution of benefits between the racing and sport sectors. This uncertainty arises because the value of the commission payment would vary depending on the agreement reached between the NZRB and the relevant NSO.

***Options for ensuring total commission payments to NSOs increase (relative to the 2016 financial year)***

65. The following figures would need to be used under each of the different formula options (GBR, NBR and profit) to ensure total commission payments to NSOs increase (relative to the 2016 financial year):

- Option one: More than 19.9 percent of GBR
- Option two: More than 22.1 percent of NBR [preferred option given the analysis above]
- Option three: More than 46 percent of profit

66. As with the previous section, these options are underpinned by calculations undertaken by the NZRB. These calculations are based on projections of the NZRB's future sports betting revenue and are subject to a number of assumptions. More information on these projections is available in the NZRB's Statement of Intent 2016-18.

***Options for allowing the wider sport sector to receive some benefit from payments made by the NZRB to the sport sector***

*Option one: NZRB required to provide a proportion of sports betting revenue to a third party to deliver benefits to the wider sport sector*

67. The Racing Act could be amended to require the NZRB to set aside a certain proportion of total commission payments so that it can be provided to a third party for the delivery of programmes that benefit the wider sport sector. This option essentially requires the NZRB to outsource some of the benefit of commission payments to a third party provider.

68. This option provides benefits to the wider sport sector if a suitable third party provider could be found. However, the third party would have to be more effective than an NSO at impacting the sport sector for this option to create any benefit over and above the status quo.

69. This option is not favoured for the following reasons:

- It would duplicate the work that Sport NZ already does in funding sports organisations
- Distribution of funding would not necessarily be aligned to Government objectives if it was provided to a third party. Therefore, the maximum return or value may not be delivered

- There would also be costs incurred by the NZRB in locating, contracting and monitoring a third party provider. These costs could outweigh any potential benefit gained by the use of a third party provider

*Option two: Sport NZ given the power to receive funds that would otherwise go to an NSO*

70. Under this option, the Racing Act would be amended to provide Sport NZ with the power to redirect part (or all) of a commission payment that would otherwise go to an NSO. This would provide benefits to the wider sport sector if it allowed Sport NZ to divert funds to an area that would provide greater benefit to the sport sector.

71. This option is not favoured because it would disrupt the current principle within the Racing Act whereby the NZRB and the relevant NSO are required to enter into a sports betting agreement to facilitate betting on the relevant sport. This principle would become unworkable if a third party such as Sport NZ was empowered to step in and redirect a commission payment that has already been negotiated and agreed between an NSO and the NZRB.

72. This option would risk removing the incentive for the relevant NSO to enter into a sports betting agreement. Without a sports betting agreement in place the NZRB would be unable to offer betting on that particular sport and would be unable to provide the sport sector with the benefits that flow from this.

*Option three: Sport NZ enters into a three-way contract with the NZRB and the relevant NSO to outline how the NSO will spend the NZRB commission payment*

73. This option would require the relevant NSO to enter into a three-way contract with the NZRB and Sport NZ. The contract would specify the commission payment the NSO would receive (as determined by the NZRB) and how this payment should be spent (as determined by Sport NZ).

74. The benefit of this option is that Sport NZ could require the NSO to spend the payment in a way that offers the greatest benefit to the wider sport sector.

75. This option is unlikely to work in practice. Requiring a three-party contract would be unworkable if all the relevant parties cannot agree. Also, the prospect of Sport NZ determining how an NSO can spend its commission payment could remove the incentive for the NSO to enter into a sports betting agreement with the NZRB. As with the previous option, this would leave the NZRB unable to offer betting on this sport and unable to provide the sport sector with the benefits that flow from this.

*Option four: a proportion of total NZRB commission payments is directed to the wider sport sector via Sport NZ [preferred option]*

76. Under this option, the formula would be amended so that a certain proportion of total commission payments is provided to the wider sector sport sector via Sport NZ. This funding would be distributed to external parties via Sport NZ's normal processes. Funding decisions would be made in consultation with the NZRB.

77. This option would allow Sport NZ and the NZRB to direct this money to where it can have the greatest impact on the wider sport sector. Sport NZ, as the government agency responsible for sport and recreation, has strong connections

with the New Zealand sport sector and has extensive experience in investing in sports organisations. In 2016, Sport NZ invested \$43 million in national and regional sports organisations.<sup>4</sup>

78. Sport NZ would invest any funding it received under this option in organisations that are best placed to achieve Sport NZ's strategic outcomes. Sport NZ would remain accountable to its monitoring agency (the Ministry for Culture and Heritage) for the way in which this funding is invested.

### ***Options for allowing greater flexibility to change the formula***

#### *Option one: status quo*

79. As noted above, the current formula is inflexible because it cannot be easily changed to respond to changes in the NZRB's betting operations. Primary legislation has to be passed to amend the formula.

80. In our view, a greater degree of flexibility is required to respond to possible future changes in the betting market and/or the NZRB's operations

#### *Option two: move the formula to regulation [preferred option]*

81. Under this option the formula would be set out in regulations made under the Racing Act.

82. This is our preferred option as it would allow the formula to be amended by going through a much simpler process. Setting the formula out in regulation would provide for a degree of flexibility to amend the formula if the current formula was no longer considered fit for purpose due to changes in the NZRB's sports betting business or other factors.

83. We do not consider the formula is the type of policy matter that needs to be set out in primary legislation and is more appropriately dealt with in regulation.

### ***Combining the preferred options***

84. Based on the above analysis, our preferred option is a new formula that sets out the following:

- A minimum of 23 percent of NBR provided to the relevant NSO; and
- 3 percent of total NBR provided to the wider sport sector via Sport NZ (initially set at 2 percent, rising to 3 percent in the second year and subsequent years)

85. We recommend this formula is set out in regulations made under the Racing Act.

86. It is important to note that this formula sets out the *minimum* amount and that NSOs would retain the ability to negotiate more than the minimum payment.

#### *Impact on NSOs and Sport NZ*

87. The table below sets out the predicted impact of the proposed new formula on total payments made to NSOs and Sport NZ (money received by Sport NZ would be distributed to the wider sector). Please note the below figures are based on projections of the NZRB's future NRB and are subject to a number of

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<sup>4</sup> Sport NZ Annual Report 2016 at page 26.

assumptions. For simplicity, we have assumed the new formula would come into effect in the 2017/18 financial year.

	17/18	18/19
Existing formula NSO payment	\$10.9m	\$12.2m
New formula NSO payment	\$11.5m	\$12.7m
Difference to NSOs	\$0.6m	\$0.48m
Sport NZ Payment	\$1m (2% NBR)	\$1.65m (3% NBR)
Total payments to the sport sector (NSOs and Sport NZ)	\$12.6m (25% NBR)	\$14.3m (26% NBR)
Total difference to sport sector	\$1.6m	\$2.1m

#### Estimated impact on individual NSOs

88. The table below shows the projected impact of the proposed new formula on payments made to individual NSOs based on figures for the 2016 financial year.

FY16 NSO	Modelled Commission Payments			Normalised Margins	
	Status Quo	23%NBR	Variance	23%NBR	Variance
Basketball	\$1,824,570	\$1,921,290	96,719	\$2,046,394	221,823
Rugby Union	\$1,118,125	\$954,590	(163,535)	\$1,575,118	456,992
Football	\$1,244,064	\$1,763,426	519,362	\$1,548,637	304,573
Tennis	\$1,064,939	\$1,157,102	92,163	\$1,064,669	(270)
Rugby League	\$1,048,745	\$1,700,418	651,673	\$1,477,331	428,585
Cricket	\$634,521	\$510,073	(124,448)	\$482,931	(151,590)
Baseball	\$332,003	\$363,629	31,626	\$406,854	74,851
American Football	\$161,174	\$174,261	13,086	\$187,634	26,460
Netball	\$95,890	\$24,722	(71,168)	\$50,785	(45,106)
Darts	\$99,994	\$62,931	(37,062)	\$85,293	(14,700)
Aussie Rules	\$75,256	\$69,909	(5,347)		
Golf	\$79,434	\$128,600	49,166		
Ice Hockey	\$59,923	\$84,572	24,649		
Boxing	\$47,764	\$96,102	48,338		
MMA	\$16,489	\$30,802	14,313		
Surfing	\$11,312	\$12,261	948		
Snooker	\$11,926	\$17,192	5,266		
Hockey	\$10,402	\$13,478	3,076		
Motorsport	\$11,365	\$20,299	8,934		
Athletics	\$3,678	\$5,758	2,079		
Bowls	\$2,783	\$3,257	474		
Cycling	\$2,680	\$3,088	408		
Speedway	\$1,514	\$978	(536)		
Motorcycling	\$1,068	\$2,466	1,398		
Shearing	\$421	\$836	416		
Squash	\$144	0	(144)		
Badminton	\$149	\$204	55		
Sailing	\$57	0	(57)		
Triathlon	\$104	\$299	195		
Swimming	\$0	\$0	0		
Softball	\$0	\$0	0		

Note: These figures will vary slightly from those reported due to accounting policies

89. The impact of an NBR formula for individual NSOs will vary depending on results and betting margin for any given period as the table above shows. The table compares the impact of the proposed new formula on all NSOs.
90. The top ten NSOs generate over 95 percent of all sports betting turnover and are highlighted in yellow. The table provides two approaches. The first is a comparison of the two different formulas against turnover and margin performance for each sport in the 2016 financial year. However, this approach is problematic in so far as it fails to distinguish between the impacts of results/match outcomes vs long-term product performance (for example, the role of in-play betting). It also includes the distorting effects of world cups (for example, Rugby World Cups 2011 and 2015, Cricket World Cup 2015, and Football World Cup 2014).
91. Therefore, for each of the top ten NSOs we have supplied an estimate based on normalised margins. This methodology attempts to describe how the NZRB expects each of the top ten sports would perform under the proposed new formula for a known amount of turnover. For each NSO we have gross betting margin performance has been normalised. This approach effectively strips out some of the year to year volatility associated with results by calculating the return based on the five-year average margin performance of each NSO across the three product groups (i.e. pre-match, in-play and multi). For example, the normalised commission payments for rugby union is what the NZRB expects the pay-out to be compared to the status quo if gross betting margins run at the five-year average. As we have noted above, actual returns to NSOs will vary year by year according to results and events. Some years this will be above the average and some years it will be below.
92. Given the potential for some individual NSOs to receive a reduced commission payment (compared to the payment they received in the 2016 financial year), Sport NZ would undertake to manage the transition period for any NSO that receives a reduced payment. Under this proposal, any NSO that receives a reduced payment as a result of the change would have that amount covered by Sport NZ for the first two years.
93. It is important to note that the new formula would set out the minimum commission payment the NZRB would be required to pay the relevant NSO. There would be nothing to prevent NSOs from seeking to negotiate a commission payment that is greater than the minimum over time.

## Summary of analysis and recommendations

Options	Improves the NZRB's financial position and competitiveness	Provides a more equitable distribution between sport and racing	Allows the wider sport sector to benefit	Ensures total commission payments to NSOs increase (relative to the 2016 financial year)	Allows flexibility to change the formula	Does not fundamentally alter the NZRB's core operations or statutory objectives	Recommendation
<b>Option 1:</b> status quo	XX	XX	XX	√√	XX	√√	Not recommended
<b>Option 2:</b> 23 % NBR to NSOs and 3 % NBR to Sport NZ, set in regulation	√√	√√	√√	√√	√√	√√	Recommended
<b>Option 3:</b> total of 21 % GBR provided to sport sector, with a certain proportion of this provided to Sport NZ, set in regulation	√	√√	√√	X (could decrease if NZRB's competitiveness negatively impacted)	√√	√√	Not recommended
<b>Option 4:</b> total 54% profit provide to sport sector, with a certain proportion of this provided to Sport NZ, set in regulation	√√	√√	√√	√√	√√	XX	Not recommended
<b>Option 5:</b> contractual agreement between NZRB and sports organisations	Unclear	Unclear	XX	XX	XX	√	Not recommended

## **Consultation**

94. The following organisations have been consulted on this regulatory impact statement:

- Department of Internal Affairs
- Ministry of Business, Innovation and Employment
- Treasury
- Ministry for Culture and Heritage
- The NZRB

95. Sport NZ and the NZRB will also consult their respective sectors on the preferred option for amending the formula. Sport NZ will undertake consultation with all NSOs that currently receive a commission payment and will provide these NSOs with the opportunity comment on the proposal. The NZRB will undertake consultation with the racing industry.

96. Feedback received from this consultation will inform the final decision on the formula change.

## **Conclusions and recommendations**

97. We recommend the formula currently set out in section 57(1)(d) of the Racing Act be replaced with a new formula. The new formula should be based on the following:

- A minimum of 23 percent of NBR provided to the relevant NSO; and
- 3 percent of total NBR provided to Sport NZ (initially set at 2 percent, rising to 3 percent in the second year and subsequent years)

98. We recommend the new formula should be set out in regulations made under the Racing Act.

## **Implementation plan**

99. A Racing Act amendment Bill is required to implement the proposed new formula.

100. We recommend the legislative instrument that implements the new formula should set out the date from which the new formula is to be used. This will provide the NZRB and NSOs with certainty as to when the new formula will come into force.

101. If the proposed new formula is implemented, then NSOs and the NZRB will need to renegotiate their sports betting agreements based on the new formula.

## **Monitoring, evaluation and review**

102. We recommend the new formula is reviewed periodically (for example, every five years) to ensure it still meets the objectives outlined in this paper.