BOOKMAKERS' COMMITTEE

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Dear Paul

THE 56th LEVY SCHEME - RECOMMENDATIONS BY THE BOOKMAKERS' COMMITTEE

INTRODUCTION

1. I am pleased to submit the Bookmakers' Committee recommendations for the 56th Levy Scheme for distribution to Board members and inclusion as an agenda item at the Board meeting scheduled for 27 October 2016.

2. The 56th Levy Scheme recommendation is intended to satisfy the desire of the Minister for Sport for the Board to consider agreement of the 56th Scheme for the period 1 April 2017 until 31 March 2018, as required under the 1963 Act (amended 1969), notwithstanding Government's plan to replace such arrangements from April 2017.

3. The Committee's position is that as a result of continuing increases in media payments to racing, bookmakers 'ability to pay' is currently diminished and will continue to reduce, during the period of the 56th Scheme. As you are aware, in his determination of the 50th Scheme, the then Secretary of State for the DCMS (Jeremy Hunt MP) made it clear that media payments were an important consideration in the assessment of the flow of funds between betting and racing and accordingly, this has been factored into the offer.

Conversely, racing's income from these same media payments will continue to grow. By implication therefore, racing's 'needs' are reduced, meaning that racing's support from the levy will diminish over the same period.

In addition, the Committee was significantly influenced by two further factors. The first is racing's willingness to sign up what they claim to be fair and sustainable rates with Online operators (as an integral part of their discriminatory Authorised Betting Partner arrangement) and secondly, the Frontier Economics report commissioned by DCMS. With regard to the former, it is understood that Online operators have signed APB arrangements at c 7% which clearly demonstrates racing's own assessment of its long term 'needs'. Whilst the Frontier Economics report had a theme of 'common interest' at its heart, it provides an up to date exposition of racing's finances which, in summary, are in rude health. We will return to consider these subjects in greater detail further in the body of this letter.

CONTEXT OF THE RECOMMENDATIONS

The Economy

4. Notwithstanding the lack of detail in the government's plans for European Brexit, it is clear that the economy is facing a number of uncertainties. Those uncertainties, coupled with a forecast increase in the rate of inflation, are expected to impact bookmakers, both retail and remote, over the next 18 months. The retail betting industry is in a fragile state with 302 shops closing in the last 2 years. According to economic analysis completed by KPMG for the ABB, 1209 shops out of a sample 6347 shops may close by 2020 if there are no regulatory or fiscal changes. These shops are either systemically loss-making or considered at-risk making less than £20,000 per year. The retail betting industry therefore, clearly has no capacity to sustain the levy at its current level particularly with ongoing and increasing media commitments.

Adjustments for Inflation

5. Although the Committee was conscious of the threat of inflationary costs and its impact on bookmakers, the Committee has recommended that the RPI increase for inflation should not be applied to 'Thresholds' and 'Flat Rate Rebate' for the period of the 56th Scheme. The Committee has also elected not to recommend an inflation-based increase to the levy contribution of on-course bookmakers.

Frontier Economics Report

6. The Committee has reviewed the report prepared by Frontier Economics and circulated to the Committee by Officials at the DCMS. This report quite rightly took account of commercial revenues from betting other than levy funds, (specifically media rights and sponsorship revenues) as netted from common interest costs. The report went on to apply a common interest costs framework that, identified illustrative costs of £10.4m (scenario A costs) plus an additional amount in the range from £6.3m to £22.1m (scenario B costs). The maximum sustainable common interest value that could therefore, be delivered by a new style levy incorporating non UK based bookmakers would be in the order of £32.5m. Whilst the Bookmakers Committee recognises that its statutory duty is limited to UK businesses, the Frontier Economics report is still relevant because it looks as the financial inputs and outflows into and from racing which, get to the heart of assessing racing's needs.

Media Payments

7. Also at the time of the Frontier Economics preparatory work the then Secretary of State (John Whitingdale MP) confirmed in a response to a question in the House of Commons, that the government would take account of media payments when looking at levy payments. The Committee takes the same view and, as part of the framing for this recommendation, believes that there are significant flows of funds from betting to racing outside the levy which must be considered. In fact, in the Frontier Economics report, it was estimated that racecourse income from media payments had grown from £89.9m to £127.8m between 2012 and 2014, an increase of 42%. Subsequently, KPMG on behalf of the Committee has taken the data as defined in the Future Economics report annex 4 and established that for the 7 largest betting operators the total media payments for GB racing are estimated to be £243m in 2017 being a 13.7% increase over payments made in in 2014.

8. The Committee were also influenced by the comments of the previous Secretary of State, the RT Hon Jeremy Hunt when determining the 50th scheme. In his letter to the HBLB chairman dated 17 February 2011, he clearly felt that media payments are a significant factor to be considered when assessing the levy. When referring to the then media deals done by racing he said, " I do not accept that those who negotiated these payments could reasonably have expected that they would have been left wholly out of account in determining future Levy schemes; they are part of the backdrop against which both the reasonable needs of racing and the amount it is reasonable to expect bookmakers to pay fall to determination".

In his determination of yield required from the bookmaker industry in that scheme he further said, " I have concluded that, taken as a whole, these payments do represent indirect payments from Bookmakers to the Racing industry which should be taken into account in determining both racing's' reasonable needs and what it is reasonable for bookmakers to have to pay".

Racing & Betting Agreements

9. Racing has for the last 12 months been agreeing new levy arrangements direct with a number of on-line operators. Whilst the Committee has no sight of those individual agreements, it is clear from operator feedback and BHA documents that these agreements set a rate of circa 7% of gross profit. The Committee is of the view that as these are the most recent agreements with remote bookmakers (which were voluntarily and willingly) entered into by Racing then, they are of significant relevance when recommending the rate covering retail and remote businesses for the 56th Scheme. These deals have been freely negotiated by Racing, at a level they have calculated to be fair, reasonable and sustainable to their business.

Total Market Gross Win

10. As you will be aware, the Bookmaker's Committee has in recent months commissioned KPMG to undertake a review of the scale of the betting market to include both retail and online (onshore and offshore) channels. The review was based around returns from seven major companies on estimated gross win on British horse racing from British customers during the levy year April 2017 - March 2018. The data provided was used to estimate the total market gross win at £940m - £980m per annum.

RECOMMENDATIONS FOR THE 56th LEVY SCHEME

11. These recommendations are put forward to ensure that there is a scheme in place for 1 April 2017 reflecting the relationship within the funding model for Racing through media contracts, voluntary and statutory levy.

Catchment. The Committee recommends that the levy should continue to be calculated based upon a percentage payment of bookmakers' gross profits on horse racing business conducted in Great Britain.

For the purpose of the 56th Scheme, this term shall mean the gross profit derived from horserace betting business conducted on horse racing taking place in England, Scotland and Wales only.

Rates.

Licensed Betting Office (LBO). Bookmakers making gross profit via betting on British horse racing in this channel will pay 7.5% of gross profit as levy.

Telephone/Internet. Bookmakers making gross profit via betting on British horse racing in these channels will pay 7.5% of gross profit as levy.

Spread Betting. Bookmakers who make gross profit from spread betting should pay levy at 2.15% of such gross profit, where it arises from British horse racing.

Exchange Betting. Operators of betting exchanges should be assessed for levy on the basis of 7.5% of their gross profits on British horse racing business, where 'gross profit' is defined as the commission deducted by the exchange from the amounts paid out by it to bettors and bet-takers.

Racecourse Bookmakers. The annual fixed free for racecourse bookmakers who stand at licensed racecourses will be retained. However, in line with earlier observations, we intend not to apply an inflationary increase and propose that the fee for the 56th Levy Scheme should remain at £240 per annum as per the 55th Levy Scheme.

Point-to-Point Only Bookmakers. In respect of bookmakers who stand only at point-to-point events and/or at harness-racing and/or trotting events, the Committee proposes that their annual fee should, in line with earlier observations, remain at £192 for the duration of the 56th Levy Scheme. Bookmakers who otherwise pay levy under other clauses would be exempt from any additional payments under this sub-paragraph.

LBO Threshold. We recommend that the threshold be retained for chains of 200 shops or fewer, subject to the threshold being applied to no greater than 30 shops selected by the operator. Again, in line with previous observations, we recommend that the threshold is held at £57,257 for the period of the 56th Levy Scheme for eligible shops. Eligible shops with a gross profit of less than £57,257 will pay a rebated charge on a sliding scale related to the percentage by which their gross profit falls short of £57,257.

Flat Rate Rebate. We recommend the continuance of a Flat Rate Rebate (FRR). We further recommend that the FRR should continue to apply only to those LBOs generating less than £61,000 gross profit from British horse racing. This would be deducted from a bookmakers' liability during the year-end reconciliation at which individual liabilities are finalised.

We propose that the FRR should be unchanged from the rates applied for the 55th Levy Scheme:

- £1,100 per LBO for the first 30 LBO's generating £60,000 or less gross profit from British horse racing in any chain and £500 for all other shops generating £60,000 or less gross profit from British horse racing in any chain for the period of the 56th Levy Scheme. Marginal relief (£500 pro rata) will apply to LBO's generating a profit from British horse racing of between £60,001 and £60,999. LBO's open for less than the full period of the 56th Levy Scheme shall attract a rebate pro-rata. The calculation would be made at the end of the levy form as a reduction of a bookmakers' total Levy liability, which could not be reduced below £0.

Default Percentage. The Committee recommends that bookmakers who are unable to measure accurately their British horse racing gross profit be required to base their declarations for levy on the average percentage of gross profit attributable to British horse racing achieved by, as a minimum, Corbetts, Gala Coral Group, Ladbrokes plc and William Hill plc in their combined LBO estate during the calendar year 1 January 2017 to 31 December 2017.

Yours sincerely

Mike O'Kane
Chairman
For and on behalf of
The Bookmakers' Committee

27 Oct 16