

Horse Racing Pari Mutuel - *Can we draw from the experience of the finance industry ?*



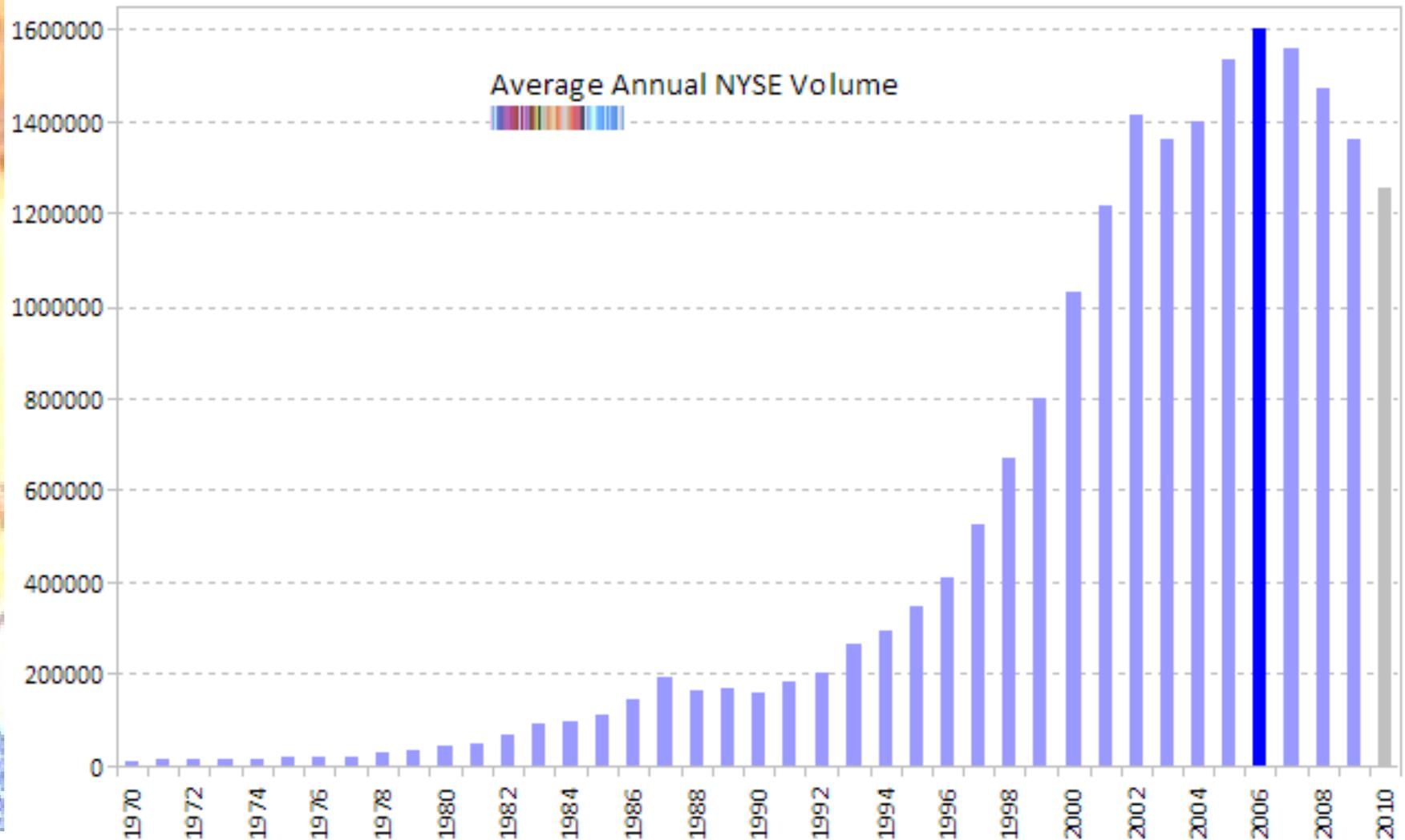
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Arnaud de Servigny

The Finance industry has completely transformed itself over the past 30 years

- Globalisation, transparency, technology, deregulation, innovation, cost reduction.
 - *Globalisation*: everybody can or should access every market
 - *Transparency*: very strict standards for availability of information
 - *Technology*: -Bloomberg is the market for me-
 - *Deregulation*: Supervisors favour “self regulation”, “codes of conduct” and operators registration over intervention
 - *Innovation*: markets are here to cater for client demand, rather than clients having to be constrained by a limited range of products
 - *Cost reduction*: transaction fees are less opaque and have gone down dramatically

The Finance industry has gone through a stellar growth until the last crisis



The Finance industry transformation

Did it work? Yes but

- + *An efficient allocation of resources: People go for what they like. Their money speaks.*
- + *Diversity of players: is considered as beneficiary, as not all act for similar purposes.*
- *Over The Counter (OTC) markets to be considered with caution: risk of mis-selling, mis-pricing and counterparty risk in the absence of clearing houses*
- *Amplification of asset bubbles*

Is the Finance industry still client friendly or has it become a “cut throat” for non professional investors?

ENTREPRISES ET SECTEURS

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Wall Street boudée par les particuliers américains



Mary Schapiro, la présidente de la ESC, a récemment alerté sur le désengagement des investisseurs particuliers dans les marchés. Elle veut y remédier en renforçant notamment la réglementation sur les acteurs professionnels.

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ET AUSSI

No free lunch on markets any more

- ✓ *The market is becoming fairer.* Trading based on privileged information has diminished very significantly. Did you know that over 3 years, on average, only 5% of mutual funds outperform their benchmark (e.g. the S&P 500)? Hence the massive development of Exchange Traded Funds (ETF) replicating benchmarks at low cost
- ✓ *Rationality over emotion.* Individual clients are prone to behavioural biases. They typically buy on regret and sell on fear. This means buy high, sell low!
- ✓ *Collective crazes.* Good ideas get oversubscribed. Groupthink gets irrational

What seems to me critical in the Horse racing / Wagering industry

4 PRINCIPLES

1. *This business should benefit horsemen. They should be in a position to benefit from an increase in the volume of transactions.*
2. *Individual punters should enjoy wagering and get the feel that they can win.*
3. *The State should benefit from appropriate taxes*
4. *Wagering volumes should not decrease and rather increase.*

Room for massive development

- ✓ *Increase the volume of information freely available to punters. (e.g. historical time series, images, etc.). Important that it is free or low cost in order to maximise market transparency*
- ✓ *Directly link transaction fees to real costs instead of focusing on rebates.*
- ✓ *Offer flexibility to clients thanks to technology. Internet is to become the standard platform of the future. Who is going to build the Bloomberg of horse-racing?*
- ✓ *The nature of trades should expand, in particular in the area of simple derivatives (e.g. Contract For Differences - CFD)*
- ✓ *Growing business maturity means a need for a distinction between regulator and operator. The regulator needs to get stronger when various operating initiatives develop.*

What should be avoided?

- ✓ *Trades without a credible clearing house:* the financial market experience has helped us to spot OTC transactions as an area of weakness. (supports Principles 1 and 3).
- ✓ *Closing rules favouring institutional players:* individual players should be able to see the odds that include the choice of professional players. Close professional wagers before individual ones. (Supports Principle 2).
- ✓ *Volumes of professional players that drive individual players out of the business.* (Small players are assumed to be less volatile than professional players). Think of a cap mechanism related to transaction fees. Rationale to be articulated. (Supports Principle 2)
- ✓ *A decay of the horse wagering industry* as it does not keep abreast with the overall gaming technology. (Principle 4)

Reasons to feel comfortable: hard for experts to beat the “wisdom of crowds”

Two examples

1. ***“The Wisdom of Crowds: Why the Many Are Smarter Than the Few”*** 2004 book by James Surowiecki
 - An example
 - 4 criteria for efficiency: diversity of opinions, independence, decentralisation, sound aggregation mechanism
2. A discussion about the contribution of Rating Agencies to the financial crisis