Office of the Minister of Internal Affairs

Cabinet Economic Growth and Infrastructure Committee

Gambling Act 2003: Review of the regulatory regime for class 4 gambling

Proposal

1. This paper is the first of two papers about gambling being considered by the Committee. This paper proposes Cabinet agreement to a review of the regulatory regime for the class 4 gambling sector (gambling on gaming machines in pubs and clubs).
2. The second paper seeks approval for increases to gambling fees under the Gambling Act 2003 (the Act). This review paper is linked to the gambling fees paper because the fees review has highlighted sustainability issues emerging in the class 4 sector.

Executive summary

1. Class 4 gambling provides important funding to a range of community purposes, particularly sport. Currently the Gambling Amendment Bill (No 3) is before the House, which makes a small number of more minor but useful improvements to class 4 gambling.
2. The gambling fees review has shown that the class 4 sector is under increasing pressure to maintain funding streams for community purposes, financially support the necessary level of regulation and absorb other costs.
3. The issues that are impacting most significantly on the sector are a complex regulatory regime, and a sector scale down, where venues and machine numbers are continuing to decline.
4. I am seeking Cabinet agreement to a broad review of the regulatory regime for class 4 gambling to determine if it remains fit-for-purpose. I want an assurance that the objectives of the Act are being met, and that the maximum benefits are being delivered to communities from class 4 gambling funding.
5. One driver for the review is the sizable shortfall between gambling fees revenue and regulatory costs, which means some government subsidisation of the sector. My proposals for gambling fees increases (set out in my accompanying paper) are required immediately to address this issue.
6. However, because the number of feasible options is limited, the significant proposed increases only partially address the problem. The large memorandum account deficit will not be fully recovered and considerable pressure will remain on the Department of Internal Affairs’ (the Department) balance sheet for the foreseeable future.
7. This indicates significant pricing and regulatory regime design problems. The proposed review will look at the alignment between the sector, the regulator and the sustainability of the regime. These aspects are interlocked, and we need to make sure we have the best framework in place if we want continued funding to the community over the longer term. Legislative changes could therefore result from the review.
8. The review will help fulfil the Department’s obligation to thoroughly assess the performance and condition of the regulatory regime for class 4 gambling, in the exercise of its regulatory stewardship role. It will look at the level at which the current regime is achieving the purposes of the Act. The review will also consider the costs of regulating the sector.
9. I have also asked officials to look at how we currently approach online gambling in New Zealand. This work is on a longer timeframe as there is currently little evidence that online gambling, particularly overseas-based gambling, is presenting a significant issue. However, this situation could change quickly. The findings of the Offshore Racing and Sports Betting Working Group, due later this year, will also be relevant to this work and give more of an indication of the size and nature of any developments in this area of the gambling sector.
10. I intend to seek a Cabinet decision to release a public discussion document on the outcome of the review of the regulatory regime in the first quarter of 2016. I will also update Cabinet on the progress of the online gambling research.

Background

Class 4 gambling provides millions of dollars annually to various community purposes

1. Corporate societies are licensed to operate class 4 gaming machines in clubs and pubs (venues) and distribute the proceeds to a non-commercial community purpose.[[1]](#footnote-1)
2. In 2014, on turnover of $8.783 billion,[[2]](#footnote-2) $806 million (including GST) was lost by gamblers on these machines, with approximately $300 million being distributed or applied to community purposes. About $256 million of the $300 million was distributed in the form of grants.
3. The remainder (roughly $506 million) paid GST, the gaming duty, the problem gambling levy, and societies’ costs (including payments to venues), as shown in Figure 1.[[3]](#footnote-3) The Department’s fees are a proportion of societies’ costs, representing about 2 per cent annually of GST-exclusive total gross proceeds ($14.44 million in the example in Figure 1).
4. Analysis of grant-making from 2004 to 2012 showed that 44 per cent of grants by value were allocated to sport, excluding racing, with rugby in particular receiving significant funding. Other purposes that receive funding include general community purposes, education, emergency services, racing, community services, arts, health, and childcare.

Recent amendments to the Act are useful improvements rather than major changes

1. The Gambling Amendment Bill (No 3) (the Bill) originated from a narrowly-scoped review of class 4 gambling that was undertaken in 2012, in conjunction with the development of the Government position on a Māori Party gambling amendment bill [CAB Min (13) 14/8 refers].
2. The Bill is awaiting the committee of the whole House stage. The Bill focuses on a small number of useful improvements to class 4 gambling. These include:

* increased transparency surrounding grants made from class 4 gambling proceeds; and
* greater administrative simplicity in the payments to venues for their costs, to reduce compliance costs.

More serious issues are apparent with the class 4 gambling sector

1. I expect the Bill to make some improvements to the way the sector is operating. However, I am aware the sector is under increasing pressure to maintain funding streams for community purposes, financially support the necessary level of regulation and absorb other costs.
2. I consider the issues can be categorised as a complex regulatory regime that drives costs, which is also impacted by the scale down of the sector.
3. I want to look at the alignment between the sector, the regulator and the sustainability of the regime. These aspects are interlocked, and we need to make sure we have the best framework in place if we want continued funding to the community over the longer term.

A complex regulatory regime

1. Class 4 gambling has high risk features that need to be carefully managed from a regulatory design perspective. It is an $800 million cash-based industry and is associated with higher numbers of problem gamblers than other forms of gambling.
2. The Act provides a very prescriptive and inputs-focused regime in response to these features. In addition to the risks presented by the form of gambling itself, the regime also has inherent structural problems. The structural problems relate to the requirement for not-for-profits to operate in a commercial setting, in combination with the following features of the gaming machine market:

* thirty-nine not-for-profit societies compete for the significant gambling revenue generated in 987 commercial venues. Societies contract with venues for the hosting of their gaming machines, with societies’ ability to reimburse venues for their costs being strictly regulated; and
* competition by societies for venues, especially high revenue venues, is intense because of the limited and declining number of machines. The ability to establish new venues is also limited by territorial authority consent requirements.

1. In the context of this competition, the Department has uncovered some cases of venue costs fraud and grant capture (where venue operators utilise their market power to illegally influence societies’ grant decision-making).[[4]](#footnote-4)
2. Regulatory costs are therefore driven by:

* the prescriptive features of the regime; and
* the high levels of regulatory oversight and complexity that attempt to dampen down the inherent conflicts in the structure, and address illegal competition.

Scale down of the class 4 sector

1. Class 4 gambling remains by far the largest of the four main gambling sectors in New Zealand. However, the number of operator societies, venues, and gaming machines has steadily declined since the Act was passed. Since 2012 gaming machine proceeds have also experienced a decline, although not as marked (see **Appendix A**).
2. During the fees review the sector expressed concern about the sustainability of a regulatory framework where future increasing costs are being imposed on a sector that is in decline.
3. The reasons for the shrinking sector need further analysis. One purpose of the Act is to control the growth of gambling, in response to the rapid expansion (and likely oversupply) of gaming machine numbers during the 1990s and early 2000s. Dropping machine numbers could be a correction after this oversupply.
4. Since the Act was passed the limitations on venues and machine numbers in the market, as a result of territorial authority class 4 venue policies, are likely to have had an impact. There may be other contributing factors, such as changing consumer preferences and behaviour.
5. The issues of regime affordability are linked to the fees model, because recovery of some of the regulatory costs relies on machine numbers, which are dropping (25,221 in 2003, now 16,579). Alternatives on which to base fees such as gaming machine proceeds, venue numbers and risk profiling have been explored, and have not, to date, provided a compelling argument for change.
6. Despite their drawbacks, fees based predominantly on machine numbers are currently preferred for reasons of certainty, transparency and administrative ease. However, the option of using gaming machine proceeds could be considered as a part of my proposed response to the issues occurring in the sector.
7. More immediately, the shortfall between fees revenue and regulatory costs needs to be resolved. As noted in my accompanying paper on gambling fees, nearly 80 per cent of the Department’s regulatory gambling costs are driven by work connected to the class 4 sector. The widening shortfall has grown into an annual operating deficit of $3.8 million and a gambling memorandum account deficit of $12.9 million at 30 June 2015. As a result government is part-subsidising the regulation of the sector.
8. This is why advancing the fees proposals is one of my high priorities. However, this is only part of the solution. The proposed class 4 fee increases of about 50 per cent are the minimum possible to maintain current regulatory levels. An increase of this size will also only reduce the deficit over a ten year period, with a significant deficit forecast to remain at the end of that time.
9. If approved, the increases will alleviate some of the immediate pressure, although considerable strain will remain on the Department’s balance sheet. Clearly this points strongly to pricing and regulatory regime design problems. Future fee increases are unavoidable (as the class 4 sector declines in size) and costs for the regulator and the sector will be difficult to contain, raising doubts about the fundamental viability of the sector and the future of the community funding it generates.

Proposal to undertake a fit-for-purpose review of the regime to understand whether the class 4 sector is sustainable

1. While my immediate priorities are to pass the Bill and to at least partially address the fees shortfall, it is also timely to consider whether the Act is delivering as it should.
2. Class 4 gambling is based on a community funding model. The levels of funding from class 4 gambling to community purposes have been dropping, from approximately $300 million in 2010, to $256 million in 2014.[[5]](#footnote-5)
3. Because of the impact on community purposes, I want to evaluate the regulatory regime for class 4 gambling to ensure that is remains fit-for-purpose. From a system perspective, I want to see that the maximum benefits are being provided to communities from the money generated by class 4 gambling.
4. The market for class 4 gambling is entirely statute based and the policy settings provide limited opportunities for growth. There is no intention to look for ways to actively reverse the decline and drive higher consumption in the market.
5. However, we need to determine if class 4 gambling is sustainable in the longer term. If the current decline continues, community funds may be seriously impacted. Therefore fully understanding the reasons for the decline, based on the available information, is important.
6. I intend to examine these issues through a review of the class 4 sector. I consider it is desirable to improve the integrity of the sector and simplify the regulatory framework. These aspects are closely linked. Addressing the fundamental structural problems will enable simplification of the framework. In that case legislative changes will be required.
7. A simplified regulatory framework could mean less regulatory oversight is required and potentially reduce the costs of regulation. The role and functions of the regulator, and a fresh look at the subsequent costs of regulating the sector, will therefore necessarily be included as part of this analysis.

The fit-for-purpose review supports the fulfilment of regulatory stewardship

1. The review will help fulfil the Department’s obligation to thoroughly assess the performance and condition of the regulatory regime for class 4 gambling.
2. Consistent with the Treasury’s guidance to departments on the exercise of their stewardship role, the work will need to clearly articulate what the class 4 gambling regime is trying to achieve, what types of costs and other impacts it imposes, and what factors pose the greatest risks to good regulatory performance.

The review will consider how the regime is performing against the purposes of the Gambling Act 2003

1. Should it be approved, the review will be a fundamental review, broadly evaluating the class 4 gambling sector based on the level at which the current regime is achieving the purposes of the Act. The Act’s purposes include:

* controlling the growth of gambling;
* preventing and minimising the harm caused by gambling, including problem gambling;
* facilitating responsible gambling;
* limiting opportunities for crime or dishonesty associated with gambling and the conduct of gambling;
* ensuring that money from gambling benefits the community; and
* facilitating community involvement in decisions about the provision of gambling.

1. I consider the purposes of the Act to be valid criteria for the review. They represent the balance of competing interests in the provision of gambling, and the stream of net benefits expected to be delivered by the gambling regulatory regime over time.

The scope of the review is broad

1. The proposed broad scope of the review of the class 4 gambling sector is shown in **Appendix B**, based on two work streams that respond to the key issues in the sector. Part one will be an environmental scan to consider the reasons for the sector scale down, and part two will be the evaluation of the regime against the objectives of the Act.

The proposed scope of the review will not cover casinos but may extend to other aspects of gambling in New Zealand

1. I do not intend the scope of the proposed review to extend to gaming machines in casinos. Casinos operate in a commercial environment that is structured and regulated in a different way to class 4 gambling.
2. Other forms of gambling may be considered, to the extent in which these impact on class 4 and may be attracting gamblers away from gaming machine use. One example is gambling on a wider range and availability of Lotto products.

Other work will examine online gambling, on a longer timeframe

1. The scope of the analysis is focused on the class 4 gambling sector. However, within my gambling work programme, I have also asked the Department to look at the government’s position on online gambling. It is now over ten years since this area was last reviewed.
2. Research indicates that gambling on overseas websites is not currently a significant area of concern for New Zealand and this work is therefore on a longer term timeframe. However, I note the findings of the Offshore Racing and Sports Betting Working Group (established by the Minister for Racing, Hon Nathan Guy) are due later this year. While the scope of the Group’s work is narrower than my proposed review of online gambling, the Group’s findings could be relevant to the Department’s work and give more of an indication of the size and nature of any problems.
3. I see it as important to progress further research and investigation in this area because it is an area where change can occur rapidly. I will report back to Cabinet next year on the progress of this work. I expect no decisions will need to be sought on our approach to online gambling until 2017.

Views of the sector and community groups on the proposal

1. I believe many sector participants and community groups will welcome the review of the regulatory regime and the sustainability of the sector, although they may have differing views on what changes should be made.
2. During the gambling fees consultation the class 4 working party (appointed by the sector to engage with the Department on the fee proposals) raised the issue of whether some of the compliance costs in the regime could be stripped out.
3. Representatives from problem gambling groups submitted on the Gambling Amendment Bill (No 3) that greater harm minimisation measures should be incorporated into the Act.

Next steps and timing of the review project

1. I seek Cabinet agreement to initiating this review of the regulatory regime and the sector. Should you agree, policy options development will begin shortly, with those options forming the basis for a public discussion document. I plan to seek Cabinet’s approval to release this public discussion document in the second quarter of 2016.
2. Following public feedback on the discussion document, I intend to report back to Cabinet on policy proposals by September 2016.

Consultation

1. The Treasury, Ministries of Health, Business, Innovation and Employment, Pacific Island Affairs, Ministries for Women and Culture and Heritage, Te Puni Kōkiri, and Sport New Zealand, have been consulted on this paper. The Department of the Prime Minister and Cabinet has been informed. The Ministry of Justice has assessed the Bill of Rights and Human Rights implications.

Financial implications

1. There are no financial implications arising from this paper. The review work will be undertaken by officials within existing Departmental baselines. Policy proposals regarding class 4 gambling are expected to be presented to Ministers next year.

Legislative implications

1. There are no legislative implications associated with the recommendations of this paper. As noted above, policy proposals regarding the class 4 gambling sector are expected to be presented to Ministers next year. This may involve change proposals that could have legislative implications.

Gender implications, disability perspective, and human rights

1. This proposal has neither gender implications, nor a need for disability perspectives. No potential inconsistencies exist between the proposal and the New Zealand Bill of Rights Act 1990, or the Human Rights Act 1993.

Publicity

1. I intend to issue a press release about the review of the class 4 sector at the same time as the fees decisions are announced.
2. I also intend to proactively publish this Cabinet paper and related Cabinet decisions on the Department’s website after the media announcement has been made, subject to consideration of any deletions that would be justified if the information had been requested under the Official Information Act 1982.

Recommendations

1. The Minister of Internal Affairs recommends that the Committee:
2. **note** that while the class 4 gambling sector remains the largest gambling sector in New Zealand, the sector is in a steady decline, is regulated under a regime that is complex and therefore costly, and is under increasing pressure to maintain funding streams for community purposes, financially support the necessary level of regulation and absorb other costs;
3. **note** that decisions are being sought from Cabinet to partially addressthe significant gap that currently exists between the fees the class 4 sector pays and the costs of regulating the sector, and reduce the current part-subsidisation by government;
4. **note** that despite the proposed significant class 4 fee increase, the current large Departmental memorandum account deficit will not be fully recovered, and considerable pressure will remain on the Department of Internal Affairs’ balance sheet;
5. **note** thatthe issues indicate significant pricing and regulatory regime design problems that require a more fundamental consideration, to look at the alignment between the sector, the regulator and the sustainability of the regime;
6. **agree** thata review is undertaken to determine if the regulatory regime for class 4 gambling remains fit-for-purpose, which will evaluate the class 4 gambling sector based on the level at which the current regime is achieving the purposes of the Gambling Act 2003;
7. **note** that a further Cabinet decision to release a public discussion document on the outcome of the review will be sought in the second quarter of 2016;
8. **note** that a report back will be provided at that time on the progress of work examining our approach to online gambling in New Zealand, which is on a longer timeframe;
9. **note** that a press release about the review of the class 4 sector will be announced at the same time as the gambling fees decisions; and
10. **note** that I intend to proactively publish this Cabinet paper and related Cabinet decisions online after the media announcement has been made, subject to consideration of any deletions that would be justified if the information had been requested under the Official Information Act 1982.

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| Hon Peter Dunne |
| Minister of Internal Affairs |

Appendix A – Numbers of class 4 gaming machines, societies, venues, and gaming machine expenditure, 2004 to 2014, showing impact on community funding

Appendix B – Two work streams of the proposed review of the class 4 gambling sector

1. As at 30 June 2015, there were 16,579 gaming machines located in 1266 licensed venues. [↑](#footnote-ref-1)
2. Turnover is the total amount wagered by gamblers before prizes are paid and includes a re-investment factor where the same dollar is counted more than once. This is particularly relevant to continuous forms of gambling like gaming machines where winnings can be reinvested immediately. [↑](#footnote-ref-2)
3. The amounts are estimates as societies report their information based on different financial years rather than by calendar year. The rate of return to authorised purposes *for societies that distribute funds* has been calculated as 41.77 per cent (of GST-exclusive total gross proceeds), based on the average return for the respective 2014 financial years. [↑](#footnote-ref-3)
4. One example of fraud is seen in the recent investigation by the Department, in partnership with the Serious Fraud Office and Organised Financial Crime Agency of New Zealand, which has led to charges being filed. [↑](#footnote-ref-4)
5. Societies have differing financial years so figures are approximate. The estimates for the remaining years in that period were: 2011, $300 million; 2012, $314 million; and 2013, $290 million. [↑](#footnote-ref-5)