In Confidence

Office of the Minister of Internal Affairs

Cabinet Economic Growth and Infrastructure Committee

New regulations to reform the Class 4 gambling framework

Proposal

1. This paper seeks approval for the development of regulations to:
   - increase the proportion of gross proceeds from Class 4 gambling returned to authorised community purposes; and
   - require a proportion of gambling proceeds to be distributed in the same region that they were generated.

2. This paper also seeks in-principle approval to develop new transparency measures for corporate societies (societies) and a commission-based payment system for recouping the costs of Class 4 gambling venues.

Executive Summary

3. Class 4 gambling is gambling using non-casino gaming machines (also known as “pokies”), regulated under the Gambling Act 2003 (the Act). In 2013, Cabinet agreed to the release of a public consultation document [CAB Min (13) 32/8 refers] with options to:
   - increase the minimum rate of return to authorised purposes;
   - increase the proportion of proceeds distributed back to the community that generated them;
   - increase the transparency of grant-making decisions; and
   - reduce compliance costs arising from compensation paid to Class 4 gambling venues by societies.

4. The Department of Internal Affairs (the Department) received 114 submissions, largely in support of reforming Class 4 gambling. However, societies opposed increasing the minimum rate of return to above 40 per cent of GST-exclusive gross proceeds (from the current 37.12 per cent). Societies argued that doing so risked reducing overall returns to authorised purposes (due to societies ceasing gambling operations at low-turnover Class 4 gambling venues).

5. I consider it is important that the proportion of gross proceeds from Class 4 gambling that are distributed to the community from Class 4 gambling are maximised, and that local communities benefit from the gaming machine proceeds generated in their area.

6. I therefore propose amending the Gambling (Class 4 Net Proceeds) Regulations 2004 (the Regulations) to increase the minimum rate of return to 40 per cent in the first financial year after the regulations come into force, 41 per cent in the third year and 42 per cent in the fifth year. The average rate of return is currently close to 41 per cent, so approximately half of societies will have to make some adjustment to meet the new minimum. A stepped increase will provide societies with time to adapt, and for the impacts to be monitored and the regulatory settings adjusted if necessary.
7. There was broad support from submitters to the principle of returning funds to the area where they were generated. I propose the introduction of new regulations to require all societies to distribute at least 80 per cent of their net proceeds in the same regional council area within which those proceeds were generated. This will ensure that the granting of funds benefits the communities that generated them. A local rate of 80 per cent at the regional level should leave sufficient flexibility to ensure that national organisations are not adversely affected.

8. I also seek in-principle agreement to develop proposals to improve the transparency of grant decision-making, and reform the system for recompensing Class 4 venue costs, subject to the passage of the Gambling Amendment Bill (No 3), which is currently being drafted by the Parliamentary Counsel Office [CAB Min (13) 14/8].

The Class 4 gambling sector

9. Class 4 gambling is gambling using non-casino gaming machines, also known as pokies, and is regulated under the Act. Societies are licensed by the Secretary for Internal Affairs to operate Class 4 gaming machines in their own clubs (e.g. RSAs and Working Men’s clubs) or in commercial venues (venues). Venues include pubs and bars. The proposals in this document only apply to non-club societies.\(^1\) As at 31 December 2013, 44 non-club societies operated 1,032 venues with 13,707 gaming machines. Venues are compensated by societies for the costs of hosting the gaming machines.\(^2\)

10. Under the Act, all net proceeds raised from Class 4 gambling operations must be returned to authorised purposes. Authorised purposes include charitable purposes, non-commercial community purposes and activities related to conducting racing under the Racing Act 2003. Money returned to authorised purposes through grants totals approximately $260 million annually.

11. Non-club societies are required by the Regulations to distribute a minimum of 37.12 per cent of their Class 4 exclusive gross proceeds to authorised purposes. If societies are unable to meet this minimum rate, the Department has the authority to revoke or not renew their operating licence. Grants to an authorised purpose can be made to recipients in any region including national or multi-regional organisations. The Act currently requires societies to publish information about applications received for grants, and whether the applications were accepted or declined.

The Department has consulted on options for reform of the Regulations

12. On 16 September 2013, Cabinet agreed to release a public consultation document [CAB Min (13) 32/8 refers] which included options to achieve four objectives:

- increasing the minimum rate of return to authorised purposes;

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\(^1\) The proposals for reform do not apply to clubs. For clubs, the minimum rate of return is a condition of the operating licence and so may be changed without regulations. Further, clubs apply their net proceeds to their own purposes and therefore are achieving 'local' returns already.

\(^2\) Payments to venues must be for actual, reasonable and necessary costs, and must not exceed cost schedules agreed with Department or payment limits set out by Gazette notice.

\(^3\) Net proceeds are defined in the Act to mean the turnover of gambling less the actual, reasonable and necessary costs, levies and taxes incurred in conducting the gambling and complying with the Act (or any other relevant Act).
• increasing the proportion of proceeds distributed back to the community that generated them;
• increasing the transparency of grant-making decisions; and
• reducing compliance costs arising from compensation paid to venues by societies.

13. The consultation period ran from 24 September to 25 October 2013. During this period, the Department received 114 submissions. Submitters included societies, venue operators, territorial authorities (TAs), problem gambling help providers, regular grant applicants and individual submitters. The Department also engaged directly with the Class 4 sector and hospitality sector stakeholders through a series of regional seminars and one-on-one meetings.

**Increasing the minimum rate of return to authorised purposes**

The goal of reform is to maximise the proportion of funding returned to the community.

14. One of the objectives of the Act is to ensure that the money from gambling benefits the community. If the net proceeds from gambling are not being maximised then community organisations and charities are missing out on opportunities to benefit from grant funding. Societies should be minimising their operating costs and maximising their net proceeds.

15. These proposals aim to maximise the proportion of funding returned to the community. Societies, on average, are currently delivering above the current 37.12 per cent minimum, with society rates of return ranging from 30.74 to 54.43 per cent in 2012. However, some societies’ returns to authorised purposes remain consistently close to the minimum required rate of return, and the improvement in the overall average rate of return has plateaued since 2007. There is scope for some societies to return more by improving the efficiency of their operations.

16. The consultation document proposed amending the Regulations to increase the minimum rate of return. Several different new minimum rates of return were considered, including 40 per cent, 43 per cent, and a phased increase to 43 per cent over four years.

**Results of consultation**

17. The Department received 88 submissions on this issue. The majority of submitters supported some increase to the minimum rate of return, while 30 per cent either supported the status quo or offered no opinion.

18. The most popular option for increasing the minimum rate was 40 per cent (26 per cent support). The majority of societies supported an increase to 40 per cent, either all at once or over several years. Options to increase the minimum rate further to either 42 per cent or 43 per cent received limited support (9 per cent for 42 and 15 per cent for 43), mostly from TAs and problem gambling support providers.

19. Societies commonly argued that increasing the minimum rate of return above 40 per cent entailed too many risks. It was stated that a minimum rate above 40 per cent would force societies to cease operating at their lower-turnover venues, which have the highest relative costs. If enough venues shut down their gaming
machines, the overall amount returned to authorised purposes would decline. This raises a particular risk for rural venues - the average rural venue raised approximately $2,600 (excluding GST) per week in 2012, compared to over $14,400 for venues in main urban areas.

Preferred option: Increasing the minimum rate of return to 40 per cent in year 1, 41 per cent in year 3 and 42 per cent in year 5

20. I propose that the Regulations be amended to increase the minimum rate of return to authorised purposes. There is a risk that if the minimum rate of return is increased too much, or too rapidly, then the aggregate amount of funding returned to the community may fall. In order to meet the new minimum rate, some societies may cease gambling operations at some of their relatively high-cost venues. Other societies may cease operations completely.

21. It is difficult to estimate how many venues will exit the sector with increased minimum rates of return. However, the decline in venue numbers would have to be significant to outweigh the increase in the average rate of return. For example, an increase in the minimum rate of return to 40 per cent would increase overall returns to the community even if the 100 lowest turnover venues (10% of the total) ceased to operate Class 4 gaming machines.

22. Further, there is the potential that existing or new societies with lean cost structures may pick up those low-turnover venues dropped by less efficient societies, resulting in no overall loss or even a potentially improved return to authorised purposes.

23. I therefore propose that the minimum rate of return be increased to 42 per cent over a five year period. Based on 2012 data, this would increase the average rate of return from 41 per cent currently to 42.7 per cent (compared to an increase to 41.5 per cent if the minimum was raised to 40). All things being equal, an increase to 42 per cent would result in an increase in distributions of $10.8 million.

24. While this option would entail some risk to the continued operation of gambling at some venues and societies, the more gradual rate of increase will allow more time to adjust, thereby easing transition costs. The average rate of return is currently close to 41 per cent, so approximately half of societies will have to make some adjustment to meet the new minimum. The Department will monitor the performance of the sector under the new required minimum rate of return, and will be able to assess whether any further adjustment to the Regulations is necessary.

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4 Any change to the minimum rate of return comes into effect in the first financial year after the regulations are amended. Societies have varying financial years, so the increase will come into effect over time.

5 This assumes that all societies currently operating below 42 per cent will increase their rate of return to exactly 42 per cent and that no societies will cease operations.
Introducing a regulation requiring a proportion of net proceeds to be distributed to the area where they were generated

The goal of reform is to ensure that communities hosting gaming machines benefit from the net proceeds generated in their area

25. This proposal aims to ensure that a significant proportion of the money raised in a geographic locality is distributed within that locality.

26. Under the Act, societies may distribute net proceeds to any geographic area provided the distribution is consistent with their own rules and authorised purposes requirements. There are no safeguards to ensure that communities benefit from the money spent on Class 4 gaming machines in their area.

27. The Gambling (Gambling Harm Reduction) Amendment Act 2013 introduced a new regulation-making power. The power enables the creation of regulations that require societies to return a specified proportion of net proceeds to a particular defined area where the proceeds were raised. The consultation document proposed two options for how to define “local distribution” (territorial authority districts and regional council boundaries) and different potential rates of local distribution (between 60 and 90 per cent).

Results of consultation

28. Of the 88 submitters that commented on this issue, 85 per cent supported the principle of returning funds to the area where they were generated. Forty-nine per cent of submitters preferred the definition of local to be based on territorial authority district (TA) boundaries, while 29 per cent supported a regional council boundary definition. The majority of societies supported a TA definition, with several indicating they already distribute grants in this manner as much as possible.

29. Those opposed to local distribution argued that it would reduce funding available to national organisations and that it would create an administrative burden upon societies and community groups. Opposition was highest amongst community groups and other grant applicants (24 per cent).

30. Submissions on the potential percentage of proceeds to be locally distributed were mixed with many submitters making no comment. Of those who did comment, nearly three-quarters supported a rate of return between 70 and 80 per cent. Many submitters also supported a higher proportion of return if a broader definition of “local” was chosen.

Preferred option: introduce an 80 per cent minimum rate of return at the regional level.

31. I propose that new regulations are introduced requiring all societies to distribute a proportion of their net proceeds within the regional council boundary in which those proceeds were generated.

32. This option will allow societies more flexibility than a TA definition in choosing how to distribute their funding. Smaller rural communities can apply for grants from a wider pool of money. Larger organisations that operate across TA boundaries will better be able to access funding. National organisations will be able to access funding for purposes that benefit specific regions.
33. A disadvantage of this option is that there will be less certainty that the geographic distribution of grants will closely match where the funding was raised. However, introducing new publication regulations (as proposed below) that require societies to report the TA where their grants are distributed to will allow the public to monitor patterns in grant distribution.

34. Because a regional definition is supported, I propose that 80 per cent of net proceeds be required to be distributed regionally. A lower local rate of returned combined with a regional definition of local would create relatively little pressure on societies to return funds locally. A local rate of 80 per cent should leave sufficient flexibility to ensure that national organisations are not adversely affected. The remaining 20 per cent of available net proceeds may be granted to any authorised purpose in any area, including at a national level.

**Increasing the transparency of Class 4 grant decision-making**

*The goal of reform is to ensure that society grant decision-making is transparent to the public*

35. It is important that the public should be able to assess the efficiency, effectiveness and fairness of Class 4 grant decision making.

36. The current publishing requirements for societies do not provide sufficient transparency to assess a society's grant-making decisions. There is also limited data on where grant funds are going (and for what purpose), compared to where the money was generated.

**Results of consultation**

37. Of the 85 submitters who commented on this issue, approximately 70 per cent supported additional reporting requirements being placed on societies. Support for more transparency was highest amongst councils (100 per cent), societies (93 per cent) and venues (73 per cent). However, community groups generally preferred the status quo (over 50 per cent), saying that current requirements were adequate.

38. Some submitters, while supportive of increased transparency, opposed the publication of certain details, either because of privacy implications (e.g. address data) or because information could be misleading (e.g. the amount of money initially sought by grant applicants versus what was eventually granted).

**Preferred Option: create new transparency requirements in regulations**

39. I propose that new transparency requirements be developed. The new requirements would concern the publication of information about, for example, the purpose of the grant, the geographic location of grant recipients, and whether a grant applicant is a local, regional or national organisation.

40. The implementation of these proposals will require passage of the Gambling Amendment Bill (No 3) (the No 3 Bill), which is currently being drafted by the Parliamentary Counsel Office. The Act requires societies to publish grant information in a newspaper. The current empowering provisions in the Act also need expansion in order for some changes to existing regulations to be made. It is intended that the No 3 Bill will amend these provisions. Following enactment, the Regulations will be amended with the new transparency provisions.
41. I seek in-principle Cabinet agreement to further development of transparency requirements, noting that finalisation of the required regulations will not be possible until the passage of the No 3 Bill. I will report back to Cabinet seeking any further detailed decisions required on this matter.

Proposals to amend the venue payments system

The goal of reform is to develop a more efficient and effective model for compensating venues

42. The current model for reimbursing venues for the costs of operating gaming machines is cumbersome, involves significant regulatory costs for the Department and imposes significant compliance costs on the sector. The money available to be returned to authorised purposes could be maximised through a more efficient and effective venue compensation model that reduces compliance costs for venues and societies.

Results of consultation

43. The consultation document proposed two main options for reform:

- changing the current system to a per-machine payment reimbursement to venues; or
- a model where venues would receive a percentage of the gaming machine proceeds raised at their venue (a commission-based payment model).

44. Of the 84 submissions on this proposal, seven supported no change and nine (mostly problem gambling support providers) supported the per-machine payment model.

45. The Department’s proposal for a tiered commission system was not supported. Submitters argued that the Department’s model paid too much to low-turnover venues and that the inclusion of a cap on venue payments was unfair on high-turnover venues with busy staff and longer hours. Nonetheless, submitters were generally supportive of commission-based payments over the status quo and were supportive of further work to develop a commission model that more accurately compensated venues for their costs.

Preferred option: introduce a commission-based payment scheme

46. Currently the Act contains a prohibition on commission payments. However, the No 3 Bill includes a provision to remove this restriction. I propose proceeding with developing a commission-based payment system, given that it is simpler than the status quo and has the potential to reduce overall costs to societies.

47. While a per-machine payment system would also reduce compliance costs, it would rely on average costs that may not fairly compensate venues for their overall costs. Further, empty venues could receive the same payments as busy venues. As a result, the per-machine payment may not reflect the actual costs being incurred, as most venues that produce higher turnover face higher costs due to longer operating hours and more intensive use of gaming machines.

48. It is evident that further work is needed to design the right type of commission payment system. The Department intends to work with representatives of the sector, to incorporate their views and come to an optimal solution. I therefore seek Cabinet agreement, in-principle, to the development of a commission-
based venue payment system, subject to the passage of the No 3 Bill. I will report back to Cabinet seeking any further detailed decisions required on this matter.

Departmental consultation

49. The following agencies were invited to comment on the proposals and their comments have been reflected in this paper: the Ministries of Health, Pacific Island Affairs, and Culture and Heritage; Te Puni Kokiri; Sport New Zealand; and the Treasury. The Officials' Economic Growth and Infrastructure Committee was also consulted. The Department of Prime Minister and Cabinet was informed.

Financial Implications

50. There are no financial implications arising from this paper.

Legislative Implications

51. Proposals to increase the minimum rate of return and return funds to the region they were generated will require development of regulations under the existing legislation.

52. The creation of a commission-based venue payments scheme and the improvement of current transparency provisions to be introduced will first require passage of the No 3 Bill, which is currently being drafted and has a priority of Category 3 (to be passed if possible in 2014) in the 2014 Legislation Programme.

Regulatory Impact Analysis

Regulatory Impact Analysis requirements

53. Regulatory impact analysis requirements apply to the proposals in this paper as new regulations are proposed. A Regulatory Impact Statement has been prepared and is attached to the Cabinet paper.

Quality of the Impact Analysis

54. The DIA RIS panel has reviewed the Regulatory Impact Statement (RIS) prepared by DIA and associated supporting material, and found that it meets the quality assurance criteria.

55. There are several areas of analysis where shortages of information has prevented the analysis from being complete, but the Panel considers these lacks do not prevent the relevant analysis from being convincing.

Human Rights implications

56. These proposals do not contain any potential inconsistencies with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

Publicity

57. I intend to issue a media release to publicise the proposed regulatory reforms following Cabinet agreement to the recommendations.
Recommendations

58. The Minister of Internal Affairs recommends that the Committee:

1. **note** that on 16 September 2013 Cabinet agreed to public consultation on [CAB Min (13) 32/8 refers]:
   1.1. increasing the minimum rate of return to authorised purposes;
   1.2. increasing the proportion of proceeds distributed back to the community that generated them;
   1.3. increasing the transparency of grant-making decisions; and
   1.4. reducing compliance costs arising from compensation paid to Class 4 venues by Class 4 societies;

2. **note** that public consultation ran from 24 September to 25 October 2013 and 114 substantive submissions were received;

3. **agree** that the regulated minimum rate of return contained in the Gambling (Class 4 Net Proceeds) Regulations 2004 be increased from 37.12 per cent to:
   3.1. 40 per cent of GST-exclusive gross proceeds in the first financial year after the regulations come into force;
   3.2. 41 per cent of GST-exclusive gross proceeds in the third financial year after the regulations come into force; and
   3.3. 42 per cent of GST-exclusive gross proceeds in the fifth financial year after the regulations come into force;

4. **agree** that regulations be made to require a proportion of net proceeds to be distributed in the same local area that generated them, with the:
   4.1. "local" area defined as the regional council area; and
   4.2. proportion distributed locally to be set at 80 per cent of net proceeds;

5. **agree** in-principle to the further development of new publication requirements for societies to increase the transparency of grant decision-making, subject to the passage of the Gambling Amendment Bill No 3;

6. **agree** in-principle to the development of a commission-based payment scheme, subject to the passage of the Gambling Amendment Bill No 3;

7. **invite** the Minister of Internal Affairs to issue drafting instructions for new regulations to give effect to recommendations 3 and 4 above; and

8. **note** the Minister of Internal Affairs intends to issue a media release to publicise the proposed regulatory reforms subject to Cabinet agreement to the recommendations.

Hon Peter Dunne
Minister of Internal Affairs

1/14/2014