

Regulatory Impact Assessment (Machinery of Regulation)

1. Title of proposal

Review of National Lottery licensing and regulation (machinery of regulation). This Regulatory Impact Assessment assesses the impact of the measures to be included in the National Lottery Bill on National Lottery licensing and regulation

2. Purpose and intended effect of measure

(i) Objective

The Government published a consultation document in June 2002 which set out options for changes to the arrangements for licensing and regulating the National Lottery. This was subject to a further review in May 2004. These set out three specific objectives, which are:

- Ensuring that the National Lottery raises as much income as possible for good causes without weakening necessary protections;
- Ensuring effective competition for its operation; and
- Maintaining public confidence in the National Lottery and the arrangements for running it.

This document sets out the Government's conclusions in relation to machinery of regulation. A separate RIA has been prepared on the proposed changes to licensing. In line with the approach set out in the consultation documents, the Government does not envisage changing the basic concept of the National Lottery. It will remain the only large-scale lottery allowed in the United Kingdom, whose purpose is to maximise income for good causes that would not otherwise be supported from public funds. Nevertheless, the changes to legislation that the Government intends to make would introduce greater competition into the licensing of the National Lottery, thereby ensuring that it raises as much as possible for good causes.

(ii) Background

Legislative framework

The 1993 and 1998 Lottery Acts set down the framework within which the UK National Lottery is operated and established the National Lottery Commission (NLC) to license and regulate the operator. The Acts do not prescribe the design of the Lottery: it is for companies wanting to run the Lottery or promote games within it to develop their own proposals. So, for example, game design, prize structure and distribution mechanisms are all left unmentioned in the legislation. What the Acts do is lay down the control framework within which the Lottery is to be managed.

This framework recognises four key parties:

- The Secretary of State, whose overriding duty is to ensure that the Lottery is run properly and that players' interests are protected and subject to that, to maximise the income for good causes. The Secretary of State has the power to give directions about how the Lottery is to be licensed, and to make regulations about how it is run.
- The NLC whose duties mirror those of the Secretary of State. The key function of the NLC is to issue and enforce licences for the operation of the Lottery. There are two kinds of licence: a licence under section 5 of the 1993 Act, which is granted to a company to run the National Lottery; and one or more licences under section 6 of

that Act, granted to companies to promote lotteries as part of the National Lottery. The role of the NLC is described in greater detail below.

- The section 5 licensee: currently Camelot. The present law allows for only one section 5 licence to be issued. It is the responsibility of this licensee to provide the technical, retailing and marketing infrastructure within which section 6 licensees can operate, and for ensuring that payments to prizewinners, the National Lottery Distribution Fund, and the Exchequer are made.
- The section 6 licensee(s), responsible for the games. At present Camelot holds all section 6 licences.

Following publication of the Gambling Review Body's report, the Government's response – **A safe bet for success** – and the publication of the National Audit Office's (NAO) report into the last licence¹, the Government has reviewed the structure of licensing and regulation through the consultation document issued in June 2002². In reaching its decisions the Government has also had the benefit of the Committee of Public Accounts' report into the award of the last licence³, the Culture, Media and Sport Select Committee's report into the Reform of the National Lottery⁴ and Joint Committee on the draft Gambling Bill report on the draft Gambling Bill⁵.

National Lottery Commission

The NLC is the statutory body created under the National Lottery Acts responsible for licensing and regulating the National Lottery. Under the National Lottery Acts the NLC has a duty to:

- Ensure that the National Lottery, and every lottery that forms part of it, is run with all due propriety;
- Ensure that the interests of every participant in the lottery are protected; and
- Subject to these two duties, to do its best to secure that the proceeds of the National Lottery are as great as possible

The NLC has the following functions:

- To issue a licence to authorise a body corporate to run the National Lottery (under section 5 of the Act). Only one such licence may be in force at any one time;
- To issue licences to authorise a body corporate to promote lotteries as part of the National Lottery (under section 6 of the Act). Each game that forms part of the National Lottery is subject to such a licence; and
- To ensure that the provisions of the licences that it grants are complied with. The NLC has a range of remedies available to it, which include publicly recording licence breaches, powers to fine, powers to seek enforcement in the High Court, and, in extreme cases, revocation.

In its role as independent regulator of the National Lottery, it ensures that the correct payments are made to the National Lottery Distribution Fund (NLDF). The NLC has no responsibility for the distribution of grants from the fund; this is the responsibility of the distribution bodies.

The NLC is a non-departmental public body funded by vote from Parliament. Its net expenditure is recovered from the NLDF and licence fees.

¹ "Awarding the new licence to run the National Lottery" Report by the Comptroller and Auditor General HC803 Session 2001-2002: 10 May 2002

² "Review of Lottery licensing and regulation: consultation document" DCMS June 2002

³ "Awarding the new licence to run the National Lottery" Committee of Public Accounts' Sixty-Fifth Report of Session 2001-2002: HC881, 6 December 2002

⁴ "Reform of the National Lottery" Fifth Report of Session 2003-04 NC196, 25 March 2004

⁵ "Draft Gambling Bill" Session 2003-04 HL Paper 63 and HC 139, 7 April 2004

(iii) Risk assessment

There is a risk that in the absence of the proposed legislative changes there will not be effective competition for the licence to run the National Lottery when the current licence ends in 2009. Eight applications for the first seven-year licence were submitted. The NLC decided to run a competition for the second licence along the same lines as the first, which resulted in only two compliant bids, although several companies had expressed an interest in bidding. The NAO report on this process considered how successful the NLC had been in achieving genuine competition for the second licence. It concluded that while there had self-evidently been a reduction in the number of bidders from 1994, the level of competition was comparable with that of other countries who run a national lottery on a similar basis. The Committee of Public Accounts has also expressed its concern about the risk that there will be no effective competition for future licences.

3. Options

In addition to the licensing changes described in a separate RIA, the consultation also suggested changes to the machinery of regulation. The status quo option would leave the National Lottery regulated by the NLC.

Some of the options described in the separate RIA on licensing changes would change the NLC's functions and size but they are not significant when set against the total potential costs and benefits arising from the licensing changes themselves. But in any event the consultation document considered whether there is a case for:

- Separating the NLC's current functions of licensing the Lottery and regulating it; or
- Whether there is a case for bringing the regulation functions within the new Gambling Commission, which the Government proposes to establish for the rest of the gambling sector.

The consultation also considered a number of options for change in the way in which the NLC is organised:

- **Chair:** the requirement of the 1998 Act that the role of chairing the NLC should rotate at least annually has caused difficulties in continuity and has few friends;
- **Executives:** The 1998 Act does not expressly preclude the appointment of a Commissioner who is also the chief executive, but leaves it unclear whether such an appointment could be made;
- **Flexibility of size:** In normal circumstances the NLC with five, all part-time, members is large enough to carry out the responsibilities set out in the 1993 and 1998 Acts. But, the process of selecting and licensing a new operator is a substantial responsibility of a different kind, requiring a wider range of expertise. This is considered further below but the case for setting up a special body, separate from the NLC, just to run a section 5 competition when one is needed is hard to argue. There may be a case for empowering the NLC to co-opt, or the Secretary of State to appoint, additional members.

4. Risks and benefits

The issue of separating the NLC's current functions of licensing the Lottery and regulating arises because, under the present arrangements, the NLC faces one very large task every seven years, in organising the award of its section 5 licence, and a less onerous set of tasks in the intervening period. It has to license new games, monitor the operator's compliance with licence conditions, vet key operator personnel and in other ways give effect to its statutory duties to protect players' interests and ensure that the Lottery is operated fairly. These are of course essential and important responsibilities. But they do not require the same

resources and effort as the big licensing decision, and the two tasks arguably do not require the same set of competences: the issue is not simply one of achieving a more even work flow.

But there are wider issues too. The establishment of a single regulator for all gambling in the form of the proposed Gambling Commission would deliver some economies of scale, for example in common functions such as personnel. And it should be easier for that body to achieve consistency of regulation, in relation for example to the measures which should be taken to protect against excessive play and to control the sale of Lottery tickets in premises selling alcohol.

However, the current role of the NLC goes beyond straightforward licensing and regulation: it has, as has been noted above, a statutory responsibility to maximise income for good causes. In this respect the contrast between the NLC and the current regulator of most commercial gambling, the Gaming Board, is instructive. Both are NDPBs, are of similar sizes and have similar regulatory objectives relating to propriety. The Board regulates casinos, bingo clubs, gaming machines and society lotteries. It has a chairman and four members, all appointed by the Secretary of State. It is funded by grant-in-aid, although fees paid by those it regulates broadly cover its costs. The NLC also has five members, all appointed by the Secretary of State. It too is funded by a net funding agreement, at a similar level.

But the Gaming Board has no responsibility for the commercial outcome of the gambling activities that it regulates, and does not license operators on the basis of a competition for a restricted number of licences. The Board's responsibility is rather to consider whether applicants meet the prescribed standards (including competence and probity) and then enforces them. How licensed operators then fare is a matter for the market. This is as true of society lotteries as for commercial gambling. The Gambling Commission, which the Government proposes will subsume the current functions of the Gaming Board, will in this respect have an equivalent relationship with the gambling industry.

What might the arguments for the separation of the NLC licensing and regulation functions be? If the NLC's role in relation to the management of the Lottery was increased, it would make no sense at all to strip it of "sponsoring and commercial" functions. Even under options 2 or 4 or the no change licensing option the arguments are unclear, because the Government wants the Lottery to prosper and there will be no direct market competition to it. Without a duty to maximise revenue for good causes it would be open to the Gambling Commission to select an operator which was wholly safe and of unquestionable integrity but also wholly ineffective. It might be argued that the operator itself has a strong incentive to maximise sales, so that no further duties on its regulator are needed. But that incentive is only there because the NLC structured the licence and competition for it in such a way as to provide that incentive. However, a regulator might approach the task quite differently depending on what its statutory duties are in respect of maximising income. Furthermore, the issue does not arise only at the initial competition stage, but throughout the licence period, whenever the NLC has to consider proposed changes to games, prizes, sale arrangements etc, in each case having to balance its current statutory duties.

It might be argued that the Government should find other ways of meeting this point. Such an argument would concede that the NLC has from the outset had a duty to maximise good causes, subject to fulfilling the essential regulatory duties; and that this combination of duties has not in practice caused serious problems. It would also concede that state-run lotteries around the world had to find ways of reconciling sales success with player protection. But it would note that the potential conflict between them was likely to become sharper in future years: especially if there was pressure to extend the promotion of games through interactive video terminals which carry more risks of addiction or misuse than traditional lottery products. The licensing proposals considered in the separate RIA have, after all, stressed the importance of innovation.

So long as the NLC retains a responsibility for the proceeds of the Lottery there are obvious arguments against contemplating its incorporation into the Gambling Commission. Clearly the Gambling Commission would be expected to treat all the gambling activities that it regulated even-handedly. The case for bringing the regulation of the Lottery under the Gambling Commission turns in part precisely on the idea of consistency of regulation. But it would always be at risk of complaints from commercial operators that it was holding them back in order to advantage the Lottery. The Gambling Commission would be judge in its own cause. On this view, consistency of regulation would be better served by greater liaison and discussion on matters of common interest between the NLC and the Gambling Commission as independent regulators.

As outlined above, the requirement that the chair of the NLC should rotate at least annually has caused difficulties in continuity of approach and has few friends. It artificially constrains the selection of members to serve on the NLC. The appointment of the chair by the Secretary of State for a fixed period would be a more normal arrangement for a public body. Likewise, the appointment of executive Commissioners would follow the normal commercial pattern where the chief executive and another member of the top executive team are members of the board. So it is in the case of the Tote. But such a change should go hand in hand with the ending of the rotating chair, so that different people would always fill the chief executive and chairman roles.

To enlarge the membership of the NLC would allow them to share the responsibility for the big decision and to make sure that, the full range of relevant interests is properly represented in the NLC's deliberations. The contrary view would be that to enlarge the NLC would probably make the decision even harder than it is now, as there would be more scope for disagreement. The NLC can, as it did before, appoint expert advisers from all relevant professional disciplines.

5. Costs

The NLC's current resources⁶ are:

Resources £ million	2002-03	2003-04	2004-05 Plans
Expenditure	3.3	4.1	3.8

The changes to licensing are not expected to have a significant impact on the total costs of the NLC but are likely to affect the pattern of expenditure across years, where a small number of licences are issued for different periods, rather than a major competition every seven years.

6. Consultation with small business

The Small Business Service has been consulted about the proposed changes. The machinery of regulation changes proposed in this document do not directly affect small firms. Small firms are currently involved in the Lottery, mainly as ticket retailers but decisions about which retailers receive Lottery terminals are a matter for the operator.

7. Competition assessment

The Office of Fair Trading has been consulted about the proposed changes. However, the proposed changes to the National Lottery licensing and regulatory regime relate more directly to the increased potential for competition for licences.

8. Enforcement and sanctions

The proposal includes no new sanctions.

⁶ "Annual Report 2004: DCMS Sponsored Bodies" Cm6220, April 2004

9. Monitoring and review

The key test for the effectiveness of the machinery of regulation changes will be the extent to which the NLC is able to deliver effective competition at the time of the new licence competition. The Government would expect the NLC to assess the effectiveness of competition following the conclusion of the next licence competition. Alongside this, the Department for Culture, Media and Sport would assess the effectiveness of the proposed changes to the machinery of regulation and in its ongoing monitoring of the NLC.

10. Consultation

There was support for a range of changes to the machinery of regulation by the NLC. But respondents generally considered that the Lottery should continue to be separately regulated by the NLC, given its duty to maximise returns to good causes.

Most of the responses recognised the special legal position of the Lottery and the unique support it provides for good causes. There was also acceptance that the regulator should continue to have its existing responsibilities. Given this responsibility, most respondents believed that to combine the regulation of the Lottery with that of the rest of the gambling sector could give rise to irreconcilable conflicts of interest for the regulator. There was general acceptance that the Lottery should therefore continue to be regulated by a separate regulator, the NLC, rather than the proposed Gambling Commission. Only one response considered that the proposed Gambling Commission should regulate the Lottery, although it recognised the difficulties inherent in such an approach.

In relation to the other changes in which the NLC is organised, there was support for: the chair to be appointed by the Secretary of State for a fixed period; for executive staff to be appointed as Commissioners, in line with general business practice; but there was no general agreement on flexibility of numbers of Commissioners. Some considered that there should be the option of extra Commissioners whilst others considered that there should be fewer but that they should be full time appointments.

11. Summary and recommendation

The Government has considered the position of the regulator of the National Lottery – currently the NLC. The Government considers that the regulator should remain responsible for maximizing returns to good causes. Given this, the Government considers that to combine the regulation of the Lottery with that of the rest of the gambling sector could give rise to irreconcilable conflicts of interest. In this, it agrees with the recommendation of the Culture, Media and Sport Select Committee. Furthermore, it is not clear that separating the functions of licensing and regulation would offer a useful way forward as there is significant overlap between the two functions. The Government therefore proposes to adopt the no change option, whereby the National Lottery remains regulated by the NLC.

The Government also considers that similar conflict of interest arguments apply against overlapping membership of the Gambling Commission and the NLC. Furthermore, the Gambling Bill provides explicitly for the Gambling Commission and the NLC to work together on issues of common interest, which might include problem gambling and player protection. The Government has agreed that, given the volume of the Gambling Commission's transitional responsibilities, it would not be feasible to transfer the regulation of the National Lottery to the Commission before the next licence competition. The government has also accepted that it would be right to carry out a value for money study of the arrangements for the regulation of the Lottery in the future. The Joint Committee on the draft Gambling Bill recommended that this study should take place two years after Royal Assent. However, given that this approach would likely result in the study taking place in the midst of the third licence competition, the Government considers that to avoid any risk of

destabilising the competition that it would be prudent for the study to take place after the next licence competition.

Nevertheless, the Government also proposes to introduce changes to the way in which the NLC is organised, thereby meeting the objective of ensuring its continued effectiveness and maintaining public confidence in the National Lottery and the arrangements for running it. The changes include removing the restriction on the number of Commissioners and ending the requirement that the chair rotates at least annually. There would instead be provision for the Secretary of State to appoint the chair for a fixed period and provision for the Chief Executive of the NLC and one other executive to be appointed as Commissioners.

12. Declaration

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

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17 November 2004

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