Office of the Minister of Internal Affairs

Cabinet Economic Growth and Infrastructure Committee

Gambling Act 2003: Review of class 4 gambling

Proposal

1. This paper:
* sets out the current state of the class 4 gambling sector; and
* seeks agreement to develop proposals for public consultation on the future sustainability of the class 4 gambling sector.

Executive summary

1. In September 2015, Cabinet agreed to a broad review of the regulatory regime for class 4 gambling to determine if it remains fit-for-purpose. Cabinet wanted an assurance that the objectives of the Gambling Act 2003 are being met, and that the maximum benefits are being delivered to communities from class 4 gambling funding. The recent increase to gambling fees has also highlighted the importance of ensuring an efficient and fit-for-purpose regulatory regime.
2. Class 4 gambling relates to gaming machines hosted in pubs, clubs and TABs. Class 4 gambling provides important funding to a range of community purposes, including sport. It has historically been the largest form of gambling by expenditure and provides the largest source of community funding from the four main gambling forms (which also include the New Zealand Lotteries Commission, the New Zealand Racing Board, and casinos).
3. Over a number of years a combination of pressures has impacted on the class 4 sector’s ability to maintain revenue and maximise benefits to the community. Factors include:
	1. a complex and expensive regulatory framework with multiple objectives;
	2. the inability of class 4 to change relative to other parts of the gambling sector and hospitality sector, particularly because of class 4 gambling’s high harm potential; and
	3. a decline in the number of societies, venues and gaming machines.
4. A major driver of the review was a fear that the class 4 sector was in severe decline and therefore community funding was under threat.
5. Analysis undertaken on the review has found that expenditure on class 4 gambling declined significantly in the first few years after the Gambling Act was passed. However, this decline was arrested from 2010-11 and expenditure has experienced a marginal increase in 2014-15. Class 4 community funding returns stabilised around the same time and appear also to be increasing.
6. There has been some consolidation of class 4 societies since the Gambling Act was passed. Ten years after the Act’s implementation a more mature class 4 sector exists, although the remaining societies are competing for a diminishing number of venues.
7. There is no evidence to support the need for urgent remedial change to the regulatory environment. However, the future of the sector and sustainability of class 4 funding remain uncertain because of:
	1. the complexity and costs associated with the regulatory model, including recent regulatory changes and increased fees;
	2. potential changes to consumer preferences in the gambling and hospitality sectors (including developments in online gambling within New Zealand[[1]](#footnote-1), and by New Zealanders gambling with offshore providers);
	3. structural inefficiencies in the class 4 sector; and
	4. potential demographic changes in the gambling population.
8. Even though expenditure has stabilised in recent years, we also should examine whether there are opportunities to maximise the amount and value of funding to communities. This includes exploring options to remove the transaction costs and other inefficiencies associated with the current gambling sector model (e.g. the high compliance and regulatory cost burden) and exploring options for Government to ensure communities benefit as much as possible from the investments from gambling revenue.
9. I therefore seek Cabinet agreement to publicly consult on how to more cost-effectively regulate the sector and ensure the long term sustainability and effective allocation of funding to communities, while also ensuring gambling-related harm is minimised. I am keen to ensure the legislation is fit-for-purpose and that current pressures on the sector do not lead to a later ‘tipping point’ that requires urgent remedial action to sustain funding to communities.
10. The Minister for Racing is developing proposals separately to deal with online racing and sports betting activities. The proposals are relevant to the class 4 review as they will potentially increase overall gambling options for New Zealanders. This work is proceeding on a separate track to the class 4 review, though I will work with the Minister for Racing to ensure that the two work streams are coordinated as much as possible.

Background

Previous Cabinet decisions

1. This paper follows Cabinet agreement in September 2015 to a review to determine whether the regulatory regime for class 4 gambling remains fit-for-purpose and is achieving the purposes of the Gambling Act 2003. These purposes include controlling the growth of gambling, preventing and minimising harm and ensuring that money generated from gambling benefits the community.
2. The review’s Terms of Reference outlined the scope of the review within the context of a primary objective of sustainable (total) grant funding to the community. It was proposed that the review, amongst other things, undertake initial environmental scanning and problem identification by the Department of Internal Affairs (the Department) and seek Cabinet’s view on future strategic direction, including whether to take the review further.
3. Cabinet noted that I would report back to this Committee in early 2016 with progress on the review [CAB-15-MIN-0074 refers].

Key features of the sector

1. Class 4 gambling relates to gaming machines hosted mainly in pubs, clubs and TABs[[2]](#footnote-2). It does not include gaming machines in casinos. Not-for-profit corporate societies own the machines and contract with commercial venues (pubs) that ‘host’ the machines for them, in return for payment. All expenditure from the machines is provided to the societies and a proportion of that is returned to communities in the form of contestable grants.
2. Class 4 societies are required to make available all net proceeds from expenditure (excluding GST) on their machines for distribution to communities, after gaming duties, taxes and levies and various other costs have been deducted. A current minimum rate of return applies of 40 per cent of GST-exclusive gross proceeds. In 2014, the average rate of return by societies was just under 42 per cent.
3. Between 40 and 50 per cent of grants by value from non-club societies are currently allocated to sport, excluding racing, with rugby in particular receiving significant funding (nine per cent). Other purposes that receive funding include general community purposes, education, emergency services, racing, community services, arts, health, and childcare (Figure 1).
4. A prescriptive regulatory framework for class 4 gambling reflects the harms associated with this form of gambling. New Zealand and international research shows that gambling harm is far more likely to be associated with the use of gaming machines than other forms of gambling. This is particularly the case for Māori, who are significantly over-represented in the class 4 gaming sector. Māori are also disproportionately represented in lower socio-economic neighbourhoods where the density of gaming machines is higher.
5. The regulatory model for class 4 gambling is also high cost. We accept a high degree of regulator costs and the running costs of around 40 societies in return for relatively open entry to the sector, and the ability for societies to undertake “grass roots” funding to specific local causes.

Summary of key findings

1. The Department conducted an environmental scan to determine the extent of the decline in class 4 expenditure, the reasons for the decline, and whether it is expected to continue in the future. The scan sought to assess the impacts of class 4 trends on levels of funding available for community grants. The key findings are summarised below.

Class 4 expenditure has declined since 2004 but recently stabilised

1. Total annual class 4 expenditure reduced significantly between 2004 and 2015, from $1,328 million to $818 million in real terms – a decline of 38 per cent (Figure 2). The decline in class 4 expenditure was the sole reason why total expenditure across the four main modes of gambling declined by 20 per cent during the period. The other modes experienced an overall increase.



1. However, from 2011, the decline in class 4 expenditure was arrested and has since been relatively stable, with a slight increase reported for 2015 (Figure 3). Further increases have been reported for the first two quarters of 2015-16.



Class 4 community funding also declined from 2004, but has stabilised

1. Total distribution of funding to community organisations from non-club class 4 gambling reduced between 2004 and 2015, from $389 million to $262 million in real terms – a decline of 33 per cent. However, funding has been relatively stable in recent years, at around $260 million per annum[[3]](#footnote-3).

Funding from across all modes of gambling combined has been relatively stable from 2004 to the present

1. Total distributions to communities from the key modes of gambling (excluding casinos) reduced by only three per cent over 2004 - 2015 in real terms (from $619 million to $603 million[[4]](#footnote-4)). This was because distributions from the Lottery Grants Board and New Zealand Racing Board increased over the period.

Other key trends

1. The class 4 sector has undergone change and rationalisation since the passing of the Gambling Act in 2003 and is now considered more stable and mature. The number of non-club societies has reduced from 107 in 2004, to 38 as at 31 December 2015, and there have been fewer societies entering or exiting the sector in recent years.
2. An overall trend of declining class 4 venues and gaming machines is continuing, but there are now more venues contracted per society, more gaming machines per venue and higher average expenditure per machine. From 2004 to 2014, the average number of venues per society increased from 16 to 24 and the number of machines per venue from 11 to 13. After being stable in recent years, the average dollar return per venue and machine increased significantly in 2015. This indicates that the sector is now operating more efficiently.
3. Despite fluctuating trends in expenditure and other key trends in recent years, there has been minimal effect on rates of gambling harm associated with gaming machines. The proportion of class 4 gamblers who are considered moderate-risk or problem gamblers reduced throughout the 1990s and has remained relatively static since. However, it appears that a small ‘core’ of at-risk gamblers exists and accounts for a disproportionate level of expenditure irrespective of wider trends.

Further regulatory changes are still to be implemented

1. A number of recent amendments to the Gambling Act, new licence and compliance fees and pending changes to regulations will have impacts on the sector in the near future. For example, new measures contained in the Gambling Amendment Act 2015 and the Gambling Amendment Act (No 2) 2015 will be implemented in 2016 and include:
	1. the introduction of a simpler venue payment regime (which should reduce compliance costs for the regulator, societies and venues);
	2. potential changes to the minimum rate of return regulations, in response to the recent rise in sector fees;
	3. standardisation of financial reporting and improvements in the publication of grant information; and
	4. other non-regulatory initiatives underway, including work to strengthen the licensing requirement for new societies, the capacity to audit management companies, and potential for lower regulatory oversight around highly trusted operators (such as through the use of three-year licences).
2. The new gambling licence and compliance fees came into effect on 1 February 2016. While they aim to cover the Department’s annual costs of regulation and reduce the deficit in the memorandum account, the ability of societies to adapt will vary. In addition, new Class 4 Game Rules that streamline and simplify the requirements for the day-to-day operation of class 4 gambling came into effect on 7 March 2016. The extent of the combined impacts of these changes may not be apparent for up to two years.

Reasons for trends in gambling expenditure, returns to communities and other indicators

1. The main drivers for the significant decline in class 4 expenditure between 2004 and 2010 were:
	1. the impact of the Gambling Act, which introduced major regulatory change and enhanced compliance and enforcement activity by the Department;
	2. the general economic environment (including the impact of the global financial crisis); and
	3. a correction to an ‘oversupply’ of gaming machines: rapid expansion of the sector in the 1990s and early 2000s caused significant unease in many communities, and was considered undesirable due to the high harm potential.
2. Other environmental factors, such as changing consumer preferences and behaviours, changing attitudes to class 4 gambling and competition from other gambling modes, may have contributed to these trends.
3. In addition, the Department considers the ability of territorial authorities to develop class 4 venue policies that limit the numbers of venues and machine numbers in their jurisdictions has likely had some impact on the market.
4. The stabilisation of class 4 expenditure since 2011 and subsequent recent growth is likely associated with a combination of factors, including:
	1. improved economic conditions;
	2. an overall increase in population, impacting on levels of expenditure in particular locations such as Auckland, Waikato and Bay of Plenty; and
	3. the efficiency gains made by societies, as discussed above.
5. There has been a trend toward a small number of large (non-club) societies holding an increasing share of the market – each operating a large number of venues. The average returns by venue and by machine have increased in line with this consolidation.

Structural inefficiencies translate to a high-cost and 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 rates of harm than other forms of gambling. Key features leading to a high cost regulatory system include:
	1. relatively open entry to the sector (subject to the licensing requirements of the Department). This has the advantage of enabling societies to be formed at the “grass roots” level around narrow and specific funding objectives, but it means significant regulatory oversight is required to keep track of 38 societies. It also means that the running costs of 38 societies are deducted from the overall pool of money available to communities;
	2. the relationship between commercial venues and not-for-profit societies. There can be intense competition among societies for high-turnover venues, which leads to a risk that some venues may attempt to exert undue influence over societies;
	3. inherent risk in the system of grants capture – the risk that some venues may exert their market power to exert inappropriate influence over societies to make grants to causes associated with the venue (rather than conforming to the fair and transparent processes anticipated by the Gambling Act); and
	4. the need to ensure that class 4 societies and venues are meeting their prevention and minimisation obligations and other responsibilities under the Gambling Act, while also maximising benefits to the community.

Future uncertainty for the Class 4 sector

1. The class 4 sector appears relatively stable at present. Current forecasts for expenditure are positive and therefore proceeds available for grants funding should be maintained or increased, at least in the short-term. The Department anticipates further consolidation within the sector, along the lines of changes over recent years. While the number of societies may remain relatively stable, the number of venues and gaming machines may continue to decline, and the average returns from venues and machines may continue to increase.
2. However, the future of the class 4 sector may be vulnerable to environmental factors, such as the state of the economy, demographic changes in the gambling population, changing consumer preferences or changes in the hospitality sector, which hosts the majority of gaming machines.
3. The complexity of the system also means that the costs of regulation will remain high. Fees for the sector may require further increases in the future as the fixed costs of the regulator are spread across a declining number of societies, venues and machines.

Proposed consultation on sustainability of class 4 sector

1. We do not have evidence that the class 4 sector faces short-term risks requiring urgent intervention. However, we also cannot guarantee the longer term sustainability of the community funding generated by the sector. I propose a programme of public consultation and engagement to discuss progress on the review to date and how to help ensure the future sustainability of funding from class 4 gambling.
2. I am keen to take a collaborative approach to this work, and try to get buy-in from the sector as much as possible on options that effectively address the long-term challenges it faces. Should Cabinet agree to proceed with further work, I propose:
	1. a short programme of targeted engagement with key members of the sector (i.e. class 4 societies, clubs, venue representatives, problem gambling service providers and consumer groups) on the draft terms of reference attached at **Appendix A**;
	2. a report-back to Cabinet in May 2016 with a draft discussion document for public release and an engagement strategy; and
	3. consultation over June to September 2016, and a report-back to Cabinet in November 2016 with the results of consultation and proposals for next steps.

Potential amendments to the Racing Act

1. The Minister for Racing is developing proposals to deal with online racing and sports betting activities that fall outside the control of New Zealand’s regulatory framework. These proposals include measures to increase the range of betting products that can be offered by the TAB at present (e.g. allowing in-race betting). They also include potential offshore consumption and data use levies targeted at offshore bookmakers, whose activities currently bypass New Zealand’s regulatory framework.
2. The proposals are relevant to the broader gambling review, as they will potentially increase the gambling options for New Zealanders, and they will be the first attempt to regulate online offshore gambling providers.
3. The Minister for Racing intends to advance this work at a more rapid pace than the class 4 review, with legislation potentially introduced in 2016. The work on racing will therefore proceed on a separate track, though the Minister for Racing and I will work closely together on any issues that require coordination across the two work streams.

Consultation

1. The Treasury, Ministries of Health, Education, 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.

Financial implications

1. There are no financial implications arising from this paper. Any further review work will be undertaken by officials within existing Departmental baselines.

Legislative implications

1. There are no legislative implications associated with the recommendations of this paper. However, future change proposals may have legislative implications.

Gender implications, disability perspective, and human rights

1. There are no gender implications, or a need for disability perspectives. No potential inconsistencies exist between the proposals in the paper and the New Zealand Bill of Rights Act 1990, or the Human Rights Act 1993. However, the disproportionately harmful impact of class 4 gambling on Māori, whanau and lower-socio-economic groups raises issues of equity.

Publicity

1. I intend to issue a press release after Cabinet has made decisions on next steps. 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 work on the review of class 4 gambling indicates that while the class 4 sector overall has declined since the passage of the Gambling Act 2003, expenditure on gaming machines has recovered in recent years and the sector has achieved a level of consolidation and maturity;
3. **note** that community funding from class 4 gambling also declined from the passage of the Gambling Act 2003, but has recovered to be relatively stable in recent years;
4. **note** that the current policy settings for class 4 gambling require high costs of regulation to ensure compliance with the legislation;
5. **note** that a number of recent and pending regulatory changes will impact on the class 4 sector; and their full impacts may not be known for up to two years;
6. **agree** to consultation with the class 4 sector to:
	1. discuss the review findings to date;
	2. gather evidence on the current and potential future state of the class 4 sector;
	3. develop a range of options for potential reform of the sector, with an objective of maximising community benefit;
7. **agree** to consultation with key parties from the class 4 sector on the draft terms of reference for the next phase of the review, attached as **Appendix A**;
8. **agree** that I report back to Cabinet in May 2016 with a draft discussion paper and engagement strategy for public consultation; and
9. **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 |
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Appendix A

Draft Terms of Reference for Review of Class 4 Gambling

Objective of the Review

The Department will work with the sector to assess whether the current class 4 gambling regime can deliver sustainable and effectively targeted funding to communities into the future. The outcome sought for class 4 gambling is a low cost, risk-based regulatory framework that ensures sustainable fund-raising for the community.

In particular, the review will:

* test the Department’s work to date regarding current and future trends that may affect the sustainability of community funding
* ensure a strong evidence base exists to enable assessment of problems and options
* assess a range of options to ensure the future sustainability and effectiveness of funding to communities

In scope

The Review will include consideration of:

* the legislative framework for class 4 gambling
* sector views on the current state of the class 4 gambling environment, including future challenges and opportunities
* non-regulatory options for the sector and government to improve current practice
* the amount of funding going to communities, and means to ensure the funding is targeted and effective in maximising benefits to the community
* provisions to ensure minimisation of harm from gambling
* an assessment of trends and issues around online gambling, including any impacts on class 4 gambling. The review also may consider some wider online gambling issues, including potential online options for Class 3 gambling operators.

Development of options

The class 4 sector, including representatives from clubs, problem gambling service providers, consumer representatives, and the public will be invited to contribute to the problem definition and suggest options for reform, in addition to any options generated by officials. Options will be developed in good faith and discussed with the sector before any final recommendations for change are made to Ministers.

Approach to engagement

This draft terms of reference will be discussed with the sector before being finalised. A public discussion paper will then be released to invite submissions. The Department will work collaboratively with the sector as far as possible, which will include:

* focused face-to-face engagement, including workshops, with a broad range of sector groups
* canvassing the sector’s ideas for definition of problems and development of options
* a ‘no suprises’ approach to development of options.

Following the engagement process, the Department will report back to the Government in late 2016 on next steps.

1. Currently, domestic online gambling is limited to specific offerings by the New Zealand Lotteries Commission (MyLotto) and New Zealand Racing Board (via TAB). [↑](#footnote-ref-1)
2. Gaming machines operate in clubs and ‘non-clubs’. Clubs include chartered clubs, sports clubs and RSAs with their own purposes for gaming proceeds generated. However, the majority of machines operate in non-club, commercial venues (especially pubs and TABs). The review has a particular focus on non-clubs, as they represent the majority of the sector, have a unique relationship with commercial operators, and manage returns to communities via contestable grant processes. References to expenditure data, proceeds generated from class 4 gambling and other indicators noted in this paper relate to the whole sector, unless stated. [↑](#footnote-ref-2)
3. In addition, clubs are returning around $50 million per annum of net proceeds to their own purposes. [↑](#footnote-ref-3)
4. Total excludes distributions by clubs to their own purposes. [↑](#footnote-ref-4)