Office of the Minister of Internal Affairs

Cabinet Economic Growth and Infrastructure Committee

Changes to the Gambling (Class 4 Net Proceeds) Regulations 2004

Proposal

1. This paper seeks approval to cancel scheduled increases to the minimum rate of return to community purposes that must be achieved by class 4 gambling societies (gambling on non-casino gaming machines). The scheduled increases may result in a reduction of the overall pool of community funding. This proposal will require an amendment to the Gambling (Class 4 Net Proceeds) Regulations 2004 (the Regulations).

Executive summary

1. I propose cancelling further increases to the minimum rate of return to authorised purposes by class 4 gambling societies, which is currently 40 per cent of GST-exclusive gross proceeds. The rate of return is scheduled to increase to 41 per cent in September 2016, and 42 per cent in September 2018. Increasing the rate of return above 40 per cent may have the unintended effect of reducing the overall pool of community funding.
2. On 9 September 2015 Cabinet agreed to release a consultation document with options to change the minimum rate of return (EGI-15-MIN-0057). This was to take into account increasing costs faced by the class 4 sector, particularly gambling fees, which increased earlier this year. The Department of Internal Affairs received 30 submissions. The majority of submitters, 18, supported cancelling further increases to the rate of return.
3. I consider it prudent to cancel further increases to the rate of return, due to the rising costs faced by societies, including increased gambling fees and costs associated with new banknotes. Increasing the minimum rate of return above 40 per cent could force societies to shed low Gaming Machine Proceeds (GMP) venues, or exit the sector altogether. This could affect the overall pool of funding available for distribution to communities. Cancelling the increases does not prevent societies returning funds at a higher rate, as the rate of return is a minimum.
4. There are also many changes occurring in the sector. These include a simpler venue payment system, standardisation of financial reporting and improvements in the publication of grant information, and other non-regulatory initiatives. The full effects of these changes are not yet known.
5. On 21 March 2016, Cabinet approved a review of the class 4 sector. Through the review process, I will be talking to the sector about how to ensure sustainable funding to communities. This could include reviewing the rate of return, or whether it is the best tool to maximise returns to the community.
6. Therefore I consider it prudent to cancel further increases to the rate at this time. The full effects of the ongoing changes in the sector are not yet known. The rate of return can be reviewed again in future, when we have more data on how the class 4 sector is coping with increased costs, and the changes occurring in the sector have bedded-in.

Background

Proceeds from class 4 gambling must be returned to the community

1. Class 4 gambling is gambling using non-casino gaming machines, also known as “pokies”. This type of gambling is carried out by non-club societies that operate machines in commercial premises (mostly bars and pubs), which are licensed by the Department of Internal Affairs (the Department). At 30 December 2015, there were 38 non-club societies, with 966 licensed venues and 13,016 gaming machines. In 2014 (most recent data) non-club societies returned approximately $261 million to communities.
2. Non-club societies are now required by the Gambling (Class 4 Net Proceeds) Regulations 2004 (the Regulations) to distribute at least 40 per cent of their GST-exclusive gross proceeds to authorised purposes. If societies are unable to meet this rate of return, the Department can suspend, cancel or refuse to renew their operating licence.

The Regulations were changed in 2014 to increase the minimum rate of return

1. As part of class 4 sector reforms initiated in 2012, the rate of return was reviewed.   
   In 2014, a decision was made to increase the rate of return in stages. The aim was to increase the proportion of proceeds that the community receives from class 4 gambling.
2. The rate of return is scheduled to increase to 41 per cent in September 2016, and 42 per cent in September 2018, and will apply to societies at the beginning of their respective financial years.

Cabinet agreed to release a consultation document on a possible minimum rate review

1. On 9 September 2015, as part of the decision to approve new gambling fees, Cabinet agreed to release a consultation document on options for changing the rate of return. This was in response to concerns about the impact of recent cost pressures, including increased fees, on class 4 societies.
2. The consultation document included four options:

* option one: status quo, retain scheduled increases to the minimum rate of return;
* option two: delay further increases to the minimum rate of return to 2020 and 2022 respectively;
* option three: cancel further increases to the minimum rate of return; and
* option four: reduce the minimum rate of return below 40 per cent of   
  GST-exclusive gross proceeds.

1. The Department received 30 submissions. The majority of submitters (22) were societies. One submission was from a representative organisation, two submissions were from individuals, two from local authorities, and three from problem gambling service providers.
2. The majority of submitters, 18 (all societies) supported option three, cancelling further increases to the minimum rate of return. Reasons for supporting this option included:

* the rate being a minimum not a maximum, therefore societies who can afford to are able to return funds to the community at higher rates;
* future cost pressures on the sector are not known, therefore the rate should not be raised at this time; and
* if in future it was shown that societies are able to cope with higher rates of return to the community, the regulations could be changed at that time.

1. Thirteen submitters supported removing the rate from regulations altogether. This was not canvassed in the consultation document, and is outside the scope of the Cabinet mandate.

Proposal to cancel the scheduled increases to the rate of return

1. I propose cancelling further increases to the minimum rate of return, for the reasons given below.

Cost pressures on the sector

1. When the Regulations were changed in 2014 to increase the rate, it was acknowledged that the sector was facing increasing costs from non-downloadable jackpots and the change to bank notes.[[1]](#footnote-1) However, this was before the 2015 decision to increase gambling fees. Increased fees came into effect on 1 February 2016, and amount to an approximate increase of 1 per cent of GMP for societies. The increases to the fees and minimum rate of return would mean a combined effect of approximately 2 per cent of GMP.
2. In 2014, 19 of the then 37 non-club societies (who distribute rather than apply their proceeds) generated net proceeds at 41 per cent or higher of GST-exclusive gross proceeds, with the remaining 18 societies generating below 41 per cent of GST-exclusive gross proceeds. Therefore about half of societies would be affected if the scheduled increase in September 2016 takes place. This number increases to 22 societies if the effect of increased fees is taken into account.
3. A combined effect of 2 per cent of GMP on top of the cost of non-downloadable jackpots and the change in banknotes may put significant pressure on some societies, as approximately 80 per cent of their costs are fixed.

Increasing the minimum rate of return too much could force societies to close venues or exit the sector altogether

1. Given the increased cost pressures on societies, continuing with the increases to the rate of return risks reducing the overall pool of community funding. This is because the easiest way for societies to increase their rate of return is to cease operating at venues which generate less turnover, and maximise yield from high GMP venues. It is also possible that, even after shedding low-GMP venues, a society may not be able to meet the minimum rate, and would exit the sector.
2. If too many venues are closed, or societies start exiting the sector, the overall pool of funding could decrease. The latest data suggests operators are already exiting some lower-GMP venues, but this could accelerate with an increase in the rate of return.
3. Rural venues are particularly vulnerable to closure as they generate lower GMP on average ($2,691 per week in 2015) than urban venues ($15,347 per week). Their closure could result in rural areas missing out on grants, as some societies tend to grant funds in the areas where the funds were generated.

Cancelling the minimum rate increases does not prevent societies from continuing to return at a higher rate

1. The rate is a minimum, and many societies already return funds to the community at a higher rate. With the passing of the Gambling Amendment Bill (No 2) last year, section 53A(b) was added to the Gambling Act 2003. It requires societies to maximise returns to the community and minimise operating costs.
2. The Department is also currently implementing a new operating model, aiming to work more closely with the sector in dealing with non-compliance, and incentivising good practice. As 21 societies are already returning above the minimum rate, the Department’s efforts could be prioritised to working with those who are struggling to meet the minimum rate, to ensure funds to the community are being maximised.

The changing nature of the sector and other regulatory changes underway make it difficult to predict future trends

1. During the first seven years after the Gambling Act 2003 was enacted, expenditure on class 4 gambling declined significantly. This decline was arrested from 2010-11 and expenditure has marginally increased in the 2014/15 financial year and the first half of 2015/16. Class 4 community funding returns stabilised around the same time and appear now to be increasing.
2. Despite marginal increases in expenditure, the number of societies and non-club venue numbers have continued to decline.[[2]](#footnote-2) This could be a sign the sector has matured and is becoming more efficient. It is too early to say whether increased expenditure will continue if society venue and gaming machine numbers continue to decline, as there have been many fluctuations in GMP over the years.
3. The future of the class 4 sector may be also be susceptible 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. There are also trends such as an increasing population and inwards migration, particularly in Auckland, where GMP is increasing.

Potential for territorial authorities to alter the environment through their venue policies

1. Territorial authorities (TAs) have the potential to affect the class 4 environment through scheduled reviews of their class 4 venue policies. For example, the Auckland Council was formed from an amalgamation of several previous TAs, with some having a sinking lid policy and some with no restrictions. Auckland Council will be reviewing its venue policy this year. Given that the Auckland region has one third of New Zealand’s gaming machines, changes to its venue policy could have a significant impact on the class 4 market.

Other regulatory changes are still to be implemented

1. A number of recent amendments to the Gambling Act 2003 and pending changes to regulations will also have impacts on the sector in the near future. These include:
   1. the introduction of a simpler venue payment regime (which should reduce compliance costs for the regulator, societies and venues, but could result in higher venue payments for some societies);
   2. standardisation of financial reporting and improvements in the publication of grant information; and
   3. other non-regulatory initiatives underway which include 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).

The class 4 sector is being reviewed

1. On 21 March 2016, Cabinet approved a review of the class 4 sector. Through the review process, I will be talking to the sector about how to ensure sustainable funding to communities. This could include reviewing the rate of return, or whether it is the best tool to maximise returns to the community. The review could therefore result in further changes in the sector.

Conclusion

1. I consider it prudent to cancel further increases to the rate at this time. The full effects of the ongoing changes in the sector are not yet known. The rate of return can be reviewed again in future if required, when we have more data on how the class 4 sector is coping with increased costs, and allow the changes occurring in the sector to bed-in. This will in turn provide the sector with some stability while the various changes, including changes to gambling fees and venue payments, are bedded in.

Consultation

1. The Treasury, Ministries of Health, Business, Innovation and Employment, Ministry for Pacific Peoples, 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.

Legislative implications

1. Drafting instructions will be issued to amend the Regulations. The amendment will seek to cancel further increases to the rate of return.

Regulatory impact analysis

1. Regulatory impact analysis requirements apply to the proposal in this paper as an amendment to regulations is proposed. A Regulatory Impact Statement (RIS) has been prepared and is attached to this paper. The Department’s RIS panel has reviewed the RIS prepared by the Department and found that it meets the quality assurance criteria.

Human rights, disability perspective and gender implications

1. There are no human rights, disability or gender implications for this proposal.

Publicity and timing

1. If Cabinet agrees, I intend to issue a media release to publicise the proposed cancellation of the scheduled increase to the rate of return.
2. I also intend to proactively publish this Cabinet paper and related Cabinet decisions online, subject to consideration of any deletions that would be justified if the information had been requested under the Official Information Act 1982.
3. If Cabinet agrees, drafting instructions will be issued to amend the Regulations. A paper would go to the Cabinet Legislation Committee in early July 2016, with the amended Regulations coming into force in mid-August 2016.

Recommendations

1. The Minister of Internal Affairs recommends that the Committee:
2. **note** on 9 September 2015 Cabinet agreed to release a consultation document with options to change the minimum rate of return to authorised purposes for class 4 societies;
3. **note** 30 submissions were received, the majority supporting cancelling further increases to the minimum rate of return;
4. **note** increasing the rate of return above 40 per cent could lead to societies closing venues or exiting the sector, which could decrease the overall pool of funding available for distribution to communities;
5. **agree** to cancel further increases to the minimum rate of return to authorised purposes by class 4 societies, which increases to 41 per cent in September 2016 and 42 per cent in 2018;
6. **agree** to drafting instructions being issued to amend the Gambling (Class 4 Net Proceeds) Regulations 2004, cancelling the scheduled increases to the minimum rate of return to authorised purposes by class 4 societies;
7. **note** I intend to issue a media release to publicise the cancellation of further increases to the minimum rate of return to authorised purposes by class 4 societies;
8. **note** I intend to proactively publish this Cabinet paper and related Cabinet decisions online, subject to consideration of any deletions that would be justified if the information had been requested under the Official Information Act 1982; and
9. **note** if Cabinet agrees to the recommendations, the amended Gambling (Class 4 Net Proceeds) Regulations 2004 should be in force by mid-August 2016.

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| Hon Peter Dunne | | | | | |
| Minister of Internal Affairs | | | | | |
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1. Societies were required to replace non-downloadable jackpots by 1 December 2015. Societies also had to modify bank note acceptors on their machines to process the new notes issued by the Reserve Bank, which costs approximately $1000 per machine, but only affect about half of the gaming machine population. All gaming machines will require a software upgrade for the new notes at a cost of approximately $30 each. [↑](#footnote-ref-1)
2. At the quarter ending 30 September 2014 (just after the increase to 40 per cent took effect), there were 41 licenced societies, 1012 non-club venues and 13,346 gaming machines. At the quarter ending 31 December 2015, there were 38 societies, 966 non-club venues, and 13,016 gaming machines. [↑](#footnote-ref-2)