

Regulatory Impact Statement

Increasing the proportion of Class 4 gambling proceeds returned to local authorised purposes

Agency Disclosure Statement

This Regulatory Impact Statement (RIS) has been prepared by the Department of Internal Affairs (the Department).

The regulatory impact statement analyses options to:

- increase the proportion of Class 4 gambling proceeds that gambling operators return to authorised purposes; and
- require a portion of the net proceeds of gambling to be distributed to the geographical area where they were generated.

This RIS also briefly discusses future reform to the gambling regulatory framework, contingent on the passage of the Gambling Amendment Bill (No 3).¹ This Bill will include provisions to allow for increased transparency of the distribution of grant money, and to reform the Class 4 venue payments model. In-principle agreement from Cabinet is sought to guide further work on these topics, and a later regulatory impact analysis will consider options to achieve these objectives should the Gambling Amendment Bill (No 3) be enacted.

While the Department has assessed the impact of different options on the sector, the analysis in this RIS is constrained by a lack of information on:

- the extent to which increasing the regulated minimum rate of return will cause gambling operations to cease some venues (pubs and clubs); and
- the geographical distribution of grants by Class 4 gambling operators.

This lack of information makes it difficult estimate the full regulatory impacts of these proposals. Risks associated with this uncertainty are mitigated to some extent by the proposal to phase in changes to the regulated minimum rate of return, and by the fact that the area of “local” return has been defined at a relatively broad level (i.e. regional council boundaries).

Paul James, Deputy Chief Executive, Department of Internal Affairs

¹ The Gambling Amendment Bill (No 3) will propose changes to improve the performance of the Class 4 regulatory framework. It is currently being drafted and is likely to be enacted in 2015.

Glossary of abbreviations and terms

Actual, reasonable and necessary costs: *Actual* – the society and venue operator must be able to show that the costs were actually incurred; *Reasonable* - the costs must be in proportion to the size of the operation, and should take into account normal market values or prices for the goods and services provided; *Necessary* – the costs must be necessary to the conduct of gambling and legal compliance.

Authorised purposes: Means a charitable purpose, or a non-commercial purpose that is beneficial to the whole or a section of the community, or promoting, controlling and conducting race meetings under the Racing Act 2003, including the payment of stakes.

Class 4 gambling: Gambling where the net proceeds are applied to or distributed for authorised purposes; where no commission is paid to, or received by, a person for conducting it; where it satisfies the relevant game rules; and it utilises a gaming machine.

Club: Voluntary association of persons combined for a purpose other than personal gain.

Gaming Machine Proceeds (GMP): the aggregate winnings, minus payouts, from Class 4 gaming machines.

Gross Proceeds: the turnover of the gambling plus interest or other investment return on that turnover plus proceeds from the sale of fittings, chattels, and gambling equipment purchased from that turnover or investment return, less prizes.

Minimum rate of return: This is the minimum amount of proceeds that a licence holder must distribute for authorised purposes and is currently equivalent to 37.12 per cent of GST-exclusive gross proceeds per financial year.

Net proceeds: The amount remaining to be distributed to authorised purposes after costs, levies and taxes have been deducted from a society's gambling turnover and any interest or earnings from investment or sale of assets.

Corporate society: A society that is incorporated under the Incorporated Societies Act 1908, or incorporated as a board under the Charitable Trusts Act 1957, or a company incorporated under the Companies Act 1993 that does not have the power to make a profit and is incorporated solely for authorised purposes. There are two main kinds of corporate societies:

- a. Club societies that operate gaming machines at their own premises and can apply the net proceeds to their own operations; and
- b. Non-club societies that operate their gaming machines out of commercial venues (pubs and clubs), and must distribute their net proceeds to authorised purposes.

The proposals in this document relate only to non-club societies.

Executive summary

1. Class 4 gambling is gambling using gaming machines in a non-casino environment (e.g. pubs and clubs). Class 4 gambling is regulated under the Gambling Act 2003 (the Act). The previous Minister for Internal Affairs developed priorities for improving the operation of the Class 4 gambling sector. In 2013, Cabinet agreed to the release of a public consultation document addressing both the Minister's priorities and other concerns about the performance of the sector. The discussion document proposed options to:
 1. increase the proportion of gross proceeds distributed to authorised purposes;
 2. increase the proportion of proceeds distributed back to the community that generated them;
 3. increase the transparency of grant-making decisions; and
 4. reduce compliance costs arising from compensation paid to Class 4 venues by societies.
2. The Department of Internal Affairs (the Department) received 114 submissions, largely in support of the proposals. This regulatory impact statement mainly considers issues (1) and (2) noted above. Issues (3) and (4) will be considered in more detail in a later regulatory impact statement.
3. In this impact analysis, the Department considers several options to address issue (1). The preferred option is to increase the regulated 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.
4. The Department has assessed the impact of increasing the minimum rate of return on non-club corporate societies (societies). The Department notes societies' concerns that increasing the minimum rate of return above 40 per cent of GST-exclusive gross proceeds (from the current 37.12 per cent) is unfeasible, and may risk reducing overall returns to authorised purposes. However, the Department considers a phased increase to 42 per cent over five years is likely to avoid some of the transition costs by providing societies with more time to adjust to the new status quo.
5. The regulatory impact statement also considers several options to address issue 2. Currently, there are no safeguards to ensure that communities benefit from the money spent on Class 4 gaming machines in their area. The preferred option is to introduce new regulations to require all societies to distribute at least 80 per cent of their net proceeds within the same regional council area in which those proceeds were generated. This option will ensure that the proceeds benefit the regional communities that generated them, while preserving the flexibility of societies to make grants to a broad variety of community groups (including national organisations).

New Zealand's gambling framework

6. All gambling in New Zealand is regulated by the Act. The Act establishes a regulatory framework across a range of gambling activities (including charity raffles, Lotto and casino gambling).
7. Class 4 gambling is gambling using non-casino gaming machines (also known as "pokies"). Societies are licensed by the Secretary for Internal Affairs to operate Class 4 gaming machines in commercial venues (e.g. pubs and bars). As at 31 March 2014, 44 societies operated 1,030 commercial venues (venues) with 13,636 gaming machines. Venues are compensated by societies for the costs of hosting the gaming machines. In

2012, money returned to authorised purposes through grants totals approximately \$260 million.

8. The environment for the operation of non-casino gaming machines is entirely a construct derived from statute and regulation. The Act intends that non-club societies operate solely for philanthropic purposes to maximise revenue for the community, and do not seek to make a profit.
9. Accordingly, normal market based incentives which drive business efficiencies (such as profit) do not operate within this regulatory framework. Rather, the framework anticipates that societies will be motivated to operate efficiently in order to maximise the philanthropic return to their chosen authorised purposes.
10. Societies are required by the Gambling (Class 4 Net Proceeds) Regulations 2004 (the Regulations) to distribute at least 37.12 per cent of their GST-exclusive gross proceeds to authorised purposes. If societies are unable to meet this minimum rate, the Department has the authority to suspend, cancel or refuse to renew their operating licence. Grants to an authorised purpose can be made to recipients in any geographic area, including national or multi-regional organisations.

Background to legislative and regulatory reform

11. In 2012, the Minister of Internal Affairs set priorities for the reform of the Class 4 sector, including:
 - increasing the proportion of proceeds that the community receives from Class 4 gambling;
 - developing a way for gambling proceeds to be generally distributed in the region where they were generated; and
 - simplifying compliance for societies, venues and the Department as well as reducing associated costs.
12. In September 2013, Cabinet agreed to release a public consultation document seeking feedback on options to:
 - increase the proportion of proceeds distributed to communities;
 - require a proportion of net proceeds to be distributed locally;
 - increase the transparency of Class 4 grants; and
 - improve the venue payments system.
13. The proposals in this document do not relate to club societies. 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.

Issue 1: Increasing the proportion of proceeds that the community receives from Class 4 gambling

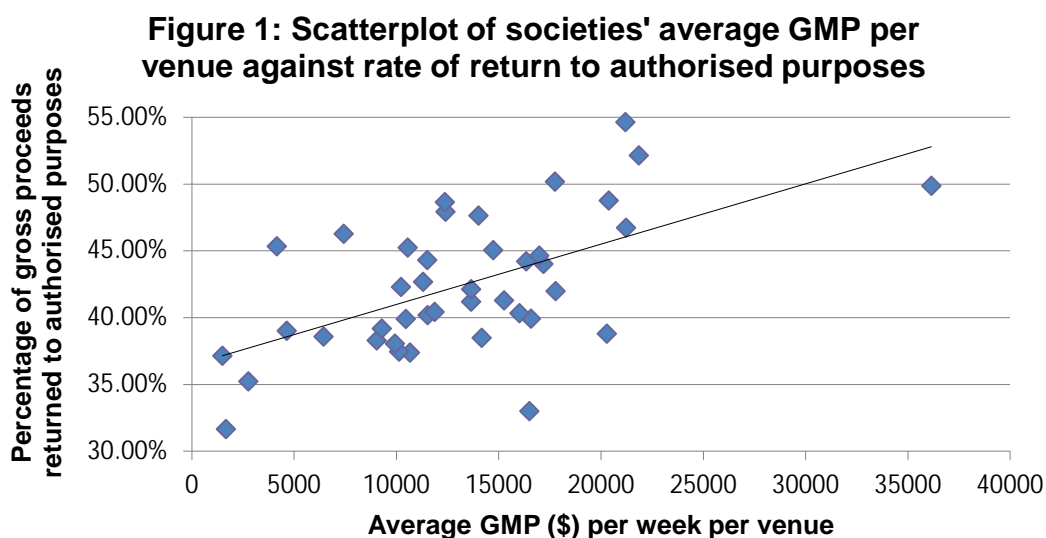
Status quo and problem definition

14. Since the Act was introduced, the average rate of return to authorised purposes by societies has risen from 37 per cent of GST-exclusive gross proceeds in 2003 to 41 per cent in 2012. However, there is variation between societies in the amount of distributions returned to authorised purposes. In 2012 society distribution rates ranged from 30.74 to

54.43 per cent of the GST-exclusive gross proceeds of gambling.² Of the 46 societies that were operating in 2012, 37 distributed between 37.12 and 45 per cent.

Influences on proportion of gaming machine proceeds returned to authorised purposes

15. The type of venues in which a society operates its gaming machines influences the proportion of GMP available to be distributed to authorised purposes. A number of the costs associated with hosting gaming machines are fixed (such as the cost of renting floor space). Therefore, venues where GMP is high are generally more efficient, as the fixed costs of operating gaming machines will take up a smaller proportion of GMP.
16. Conversely, the costs of operating gaming machines will take up a relatively high proportion of GMP venues where GMP is low. Therefore, a society that operates mainly out of high-GMP venues would generally need to spend a lower proportion of GMP on venue and other expenses, leaving more to be returned to authorised purposes.



17. The Department has analysed the relationship between society returns to authorised purposes and societies' average GMP per venue (see figure 1 above).³ While there is considerable variation, the graph shows a positive relationship, indicating that a society's mix of venues is partially responsible for the amount returned to authorised purposes.
18. Another influence on the proportion of gross proceeds returned to authorised purposes is how efficiently the costs of a Class 4 gambling operation (e.g. venue payments, society staffing costs, etc.) are managed. As the regulator, the Department has concerns that some high-GMP venues use competition between societies to seek weekly venue payments that are above what is actual, reasonable or necessary. Excessive venue payments reduce the amount of funding available to be returned to authorised purposes.

² Calculated based on figures from the 2012 calendar year. Amongst the five societies returning less than 37.12 per cent, two licences were renewed as shortfalls were small and unlikely to be repeated, two were under consideration, and one licence was not renewed. The Runanga Community Swimming Pool Trust was removed from the analysis as it represented a significant statistical outlier (rate of return of 62 per cent, with an average weekly GMP of \$1581 per week).

³ The average GMP per week and percentage returned to authorised purposes figures are from 2012.

19. The type of operating model that a society adopts may also influence the net proceeds distributed to authorised purposes. For example, societies connected to licensing trusts may be able to leverage lower rental payments in order to reduce costs and increase the rate of return. Additionally, some of the smaller single venue trusts operate with the support of volunteers and the local community, resulting in a lower operating cost and thus a higher rate of return.

Outcomes of public consultation

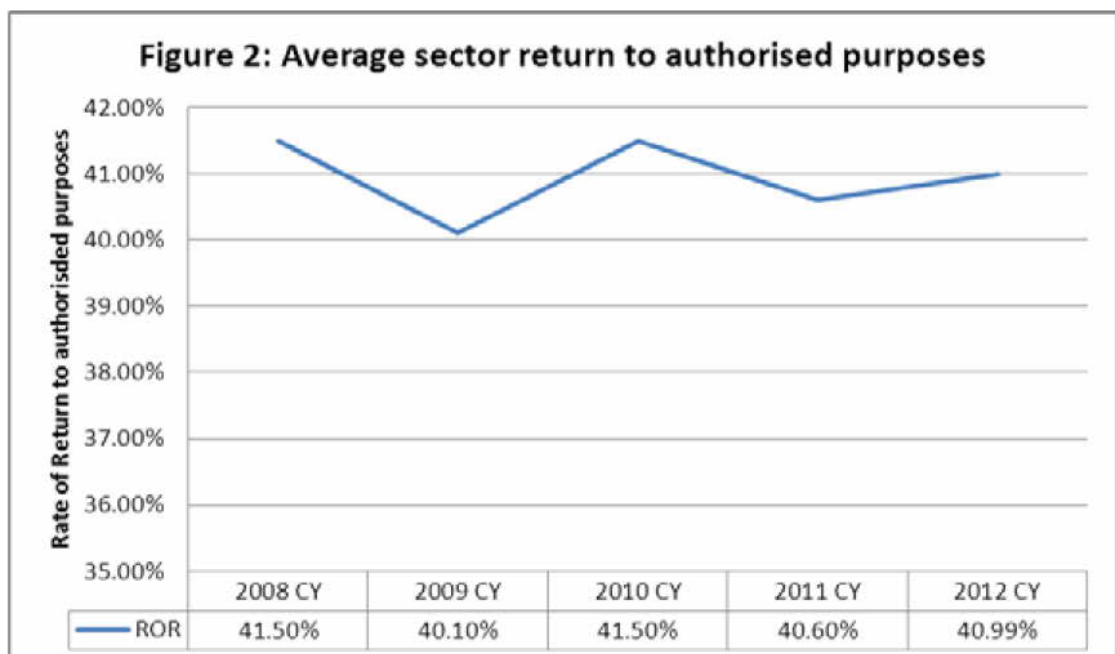
20. Territorial authorities (100 per cent), problem gambling support groups (100 per cent) and societies (75 per cent) strongly supported increases to the minimum rate of return. Community groups and venues generally opposed an increase because they were concerned that it could reduce the number of Class 4 venues, and the overall funding available for distribution.

21. There was no consensus on how much the minimum rate of return should be increased. Societies commonly argued that increasing the minimum rate of return above 40 per cent entailed too many risks, especially for rural venues and grant recipients. By comparison, territorial authorities generally supported an increase to 42 or 43 per cent, while problem gambling support groups most commonly supported an increase to above 50 per cent.

22. A number of societies also raised concerns that possible future harm minimisation requirements may make it difficult to meet an increased rate of return. The potential impacts of this issue would be considered in more detail if and when new harm minimisation requirements are proposed and/or regulated.

Problem definition

23. The majority of societies are already meeting the minimum rate of return. However, while the average rate of return by societies has increased since 2003, the rate of increase has been largely static in the last five years (see figure 2 below). Further, while the average rate of return is around 41 per cent, a number of societies' returns to authorised purposes remain consistently close to 37.12 per cent.



24. The Act intends that societies maximise the philanthropic returns to authorised purposes and minimise the costs of operating Class 4 gambling. However, the Department has repeatedly found evidence of excessive expenses, particularly to venues. These expenses include venue enhancements, overstatement of hours worked and unnecessary equipment purchases. A Departmental analysis of venue cost schedules also noted that the costs claimed by venues are reasonable but possibly not actual or necessary.⁴
25. Furthermore, many societies already achieve rates of return that are far above the average for the sector. While the types of venue (i.e. low or high-GMP) a society operates influences the rate of return, there is clearly scope for some societies to distribute more by improving the efficiency of their operations. The Minister has therefore prioritised increasing the proportion of gross proceeds that community organisations and charities receive from Class 4 gambling.

Objective

26. The objective of these proposals is to maximise the proportion of gross proceeds returned to authorised purposes by Class 4 gambling societies. The following criteria were used to assess the options:
- Will the option increase the proportion of gross proceeds returned to authorised purposes?
 - Is the option able to be implemented without reducing the overall returns to authorised purposes?
 - Is the option able to be implemented with minimal compliance costs?

Options and impact analysis

27. The Department considered three main options to maximise the proportion of gross proceeds returned to authorised purposes:
- Amending the regulations to increase the universal minimum rate of return (preferred option);
 - Non-regulatory engagement with societies to increase return to authorised purposes; and
 - Amending the regulations to vary the minimum rate of return depending on a society's mix of venues.

Preferred Option - amend regulations to increase the universal minimum rate of return

28. The preferred option is to amend the Gambling (Class 4 Net Proceeds) Regulations 2004 to increase the minimum amount that a society must distribute to authorised purposes.
29. This option, if designed optimally, achieves the objective because it will ensure an increase in the proportion of gross proceeds returned to authorised purposes without reducing the overall funding return, and can be implemented with minimal compliance costs.

⁴ In late 2009 the Department developed a new standardised form for venue cost schedules, and required all societies to resubmit their venue costs schedules using the new standard. The submissions were evaluated using a consistent methodology, and the results were published in 2013 as the Venue Cost Resubmission Report.

Sub-options

30. Three sub-options for increasing the minimum rate of return have been considered. All involve increasing the rate of return to 40 per cent in the first financial year after the regulations come into force. The minimum rate would then either:

1. remain at 40 per cent;
2. increase again to 42 per cent in year 2; or
3. increase to 41 per cent in year 3 and 42 per cent in year 5.

Table 1: Effect of an increase in the minimum rate of return on returns to authorised purposes

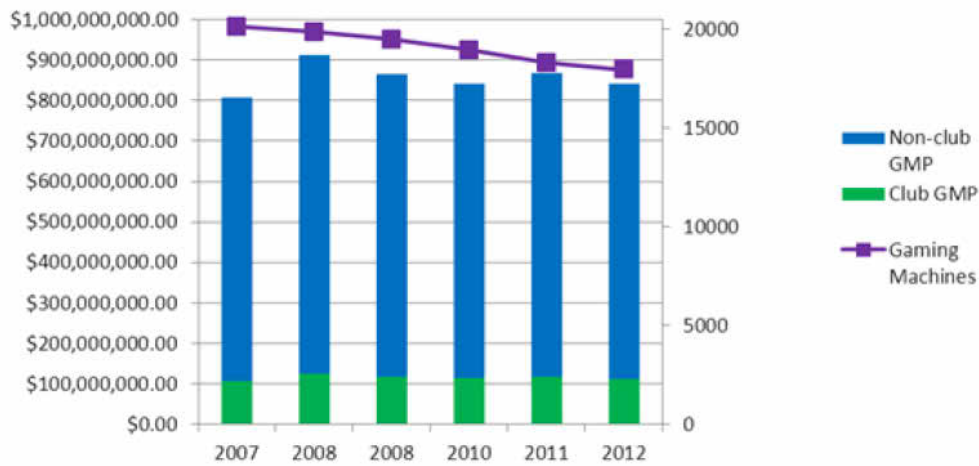
Option	Minimum rate of return	Societies Impacted	Funds distributed (\$)	Average rate of return	Extra Distributed (\$) to authorised purposes
Status Quo	37.12 per cent	0 of 44	260,750,150	40.99 per cent	0
Sub-option 1	40 per cent	17 of 44	264,160,366	41.53 per cent	3,410,216
Sub-option 2	41 per cent	24 of 44	266,894,443	41.96 per cent	6,144,293
Sub-option 3	42 per cent	27 of 44	271,631,960	42.70 per cent	10,881,810

Note: These estimates are based on data from the 2012 calendar year. The estimates assume that all societies currently distributing below 40 per cent of GMP will increase their rate of return to the new minimum and no higher. The estimates assume that societies earning more than 40 per cent of GMP will not change.

31. A small increase in the minimum rate of return (particularly anything below 40 per cent) will have little effect on the average rate of return, as most societies are already making returns to authorised purposes at this level. As a result, holding all else equal, an increase in the minimum rate of return to 40 per cent would achieve only a modest increase in the proportion of overall returns (see table 1 above).
32. The more the regulated minimum rate is increased, the greater the average rate of return by societies will be. However, increasing the minimum rate by too much, or too quickly, risks reducing overall returns to authorised purposes. This is because the easiest way for societies to quickly increase their rate of return will be to cease operating at lower-GMP venues and maximise yield from high-GMP societies.
33. It is not certain that a decline in venue numbers will mean a reduction in overall funding available for authorised purposes. In recent years, small declines in the number of gaming machines has not led to a commensurate reduction in the overall GMP raised from Class 4 gambling (see Figure 3 below). Between June 2010 and September 2013, the average amount of GMP raised at a venue increased from approximately \$160,000 per year to more than \$172,000. This suggests that if the decline in venue numbers is modest, the remaining venues will be able to absorb the excess demand as Class 4 patrons shift to the other venues.⁵

⁵ <http://www.dia.govt.nz/Resource-material-Information-We-Provide-Gaming-Statistics#one1>

**Figure 3: GMP and gaming machine numbers by venue type
2007-2012**



34. An increase to 42 per cent would require more than half of societies to raise the proportion of proceeds returned to authorised purposes. Some would need to achieve very large increases in returns. If such an increase was implemented over two years, it is possible that societies would significantly reduce the number of low GMP Class 4 venues they operate.
35. Rural venues⁶ would be particularly vulnerable as they experience lower GMP on average (\$2600 per week in 2012) than urban venues (\$14,400 per week). It is also possible that even after shedding low-GMP venues, some societies may not be able to achieve an increased rate of return, and may exit the sector. As a result, the total GMP available to be distributed to authorised purposes may fall, especially in rural areas. The risk of reduced equity of access to funding could be aggravated by the introduction of a minimum rate of local return (which is discussed later in this RIS).
36. Alternatively, existing or new societies with lean cost structures pick up those low-GMP venues dropped by less efficient societies, meaning no overall loss or a potentially improved return to authorised purposes.
37. There is also a risk that competition for high GMP venues may intensify. Societies could offer high-GMP venues more inflated venue payments in order to secure their services and increase their average rate of return. This risks further reducing the overall amount of net proceeds available for distribution. However, unwanted competition for venues will be constrained by the fact that societies will still need to retain enough net proceeds to meet the increased minimum rate of return. Further, there are options to reform the venue payments system that would reduce competition for venues (such as introducing a commission-based payment scheme). In-principle agreement from Cabinet is being sought to reform the venue payments system, and detailed regulatory analysis on options to do so will be undertaken after passage of the Gambling Amendment Bill (No 3).
38. Because different societies have different cost structures, operating models and types of venues, it is impossible to know precisely how the sector will adapt and how many venues will exit the sector at different 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, if the 100 lowest GMP venues (10 per cent of all venues) ceased gambling operations, that would result in an overall reduction in GMP of approximately \$2

⁶ Location has been defined in accordance with Statistics New Zealand's categorisation of location: http://www.stats.govt.nz/browse_for_stats/people_and_communities/Geographic-areas/urban-rural-profile/defining-urban-rural-nz.aspx

million (such a reduction could be balanced by an overall increase in funding of \$3 to \$11 million – see table 1).⁷

39. A more gradual increase to the new minimum rate of return is likely to avoid some of the negative impacts (e.g. reduced numbers of venues) described above. The more gradual approach will provide societies with additional time to adjust to the higher minimum rate, and increase the overall efficiency of their operations. It will also allow the Department time to identify if there is a significant impact in terms of declining venues and GMP, and introduce new regulations to adjust the rate if deemed necessary.

Preferred option

40. An increase to 40 per cent minimises risk and will still ensure some increase in the amount returned to authorised purposes. However, raising the minimum rate to 42 per cent over five years is the preferred option as it will best meet the objective of reform (see table 2 below). It will require more societies to return a greater proportion of proceeds to authorised purposes, and ensure a higher average rate of return. Whilst this option does entail greater risk, the phased increase to 42 per cent will provide time for societies to adjust, and for the Department to monitor the impacts and adjust regulatory settings if required.

Other options considered

Option: Non-regulatory approaches to increase return to authorised purposes

41. The Department works to educate societies about the framework of the Act, and in particular the means to maximise returns and minimise costs. However, it is the experience of the Department as the regulator that non-regulatory approaches will be unsuccessful at achieving an increase in the proportion of gross proceeds returned to authorised purposes. Over the past four years, gambling compliance audits have uncovered evidence (e.g. excessive venue payments and society operating expenses) that some societies are not maximising the efficiency of their operations. The Department does not consider that non-regulatory approaches will create sufficient incentives to materially increase returns to authorised purposes above current levels.

Option: Amend regulations to vary minimum rate of return by the mix of venues

42. The Department also considered two alternatives to an increase to the regulated minimum rate of return. In consultation with the sector, one society proposed that because high-GMP venues are more efficient and allow more funding to be returned to authorised purposes, the rate of return should vary depending on a society's average GMP generated per machine.
43. This option would help to reduce competition for high-GMP venues, and could also reduce the impact on rural venues by allowing societies with a high proportion of low-GMP venues a lower rate of return. However, the primary drawback to this proposal was

⁷ This estimate is calculated by analysing venue data from the Venue Cost Resubmission project, and ordering venues by their average weekly GMP.

the significant compliance costs associated with its implementation. The Department would need to closely monitor shifts in average GMP per machine, and societies would need to be prepared to increase and decrease their rate of return over a relatively short time-span. For these reasons, this option was not preferred.

Summary of options considered

44. Table 2 below summarises the analysis of the different options against the assessment criteria.

Table 2: Impact analysis of different options for increasing returns to authorised purposes

Option	Assessment against criteria		
	Impact: Increase proportion of gross proceeds to authorised purposes?	Impact: Effect on overall returns to authorised purposes	Impact: Compliance costs?
Preferred option: amend regulations to increase minimum rate of return			
Sub-option 1: Increase to 40 per cent in year 1	Low impact - most societies return this rate already	Low impact – Likely to be a small increase	Low impact – can be implemented under current reporting framework
Sub-option 2: Increase to 40 per cent in year 1, 41 per cent in year 3 and 42 per cent in year 5 (preferred option)	High impact in the medium term – over the first 5 years, the increase in returns will be smaller	Medium impact – the larger increase will be difficult to adjust to but societies will have extra time to do so	Low impact - can be implemented under current reporting framework
Sub-option 3: Increase to 40 per cent in year 1 and 42 per cent in year 2	High impact in short term – a rapid increase that will require the majority of societies to increase their rate of return	High impact – the larger increase in a short space of time may lead to closures of venues and a reduction in net proceeds	Low impact - can be implemented under current reporting framework
Other options considered			
Non-regulatory approaches	Low impact – does not create strong incentives to increase returns	Low impact – no effect on overall net proceeds	Low impact – no new compliance burden on societies
Vary the rate of return depending on the mix of venues	Medium impact – would depend on the design of the model	Unclear impact	High impact – would require significant monitoring to implement
Note, boxes shaded green indicate a positive impact, boxes shaded orange indicate a moderate impact and boxes shaded red indicate a negative impact.			

Issue 2: Ensuring a proportion of net proceeds are distributed in the area they were generated

Status Quo and Problem

45. Under the Act, societies may distribute net proceeds to any geographical area provided the distribution is consistent with their own rules and authorised purposes requirements. A number of societies report that they distribute most or all of their net proceeds according to where those proceeds were generated. However, the Department does not have robust information on where grants are distributed. As a result, it is not clear whether societies are, or are not, returning funds to the community that generated them.

46. The Department investigated trends in the geographic distribution of grant funding. We have conducted some high level analysis based on the information that societies publish in newspapers or on websites. This indicates that in 2012, an estimated 44 of 67 districts received more than 40 per cent of net proceeds generated in their area. It is estimated that 15 out of 17 regions received more than 40 per cent.⁸ Within single territorial authorities, an estimated eight districts received grants totalling more than 80 per cent of the net proceeds generated in that district.

Problem Definition

47. Public submissions to the Commerce Committee on the Gambling (Gambling Harm Reduction) Amendment Act 2013 revealed that there was widespread public support for the principle of funds from Class 4 gambling being required to be returned in the same area that generated them. In 2012, the Minister of Internal Affairs made it a priority to develop a way for gambling proceeds to be generally distributed in the area where they were generated.

48. It is not clear whether societies are, or are not, returning funds to the communities that generated them. The problem is that under the current regulatory framework, there is no mechanism to ensure that a proportion of GMP is returned to the area in which it was generated.

Objectives

49. The objective of these proposals is to ensure that a minimum proportion of money raised in a geographic area is distributed within that locality.

50. Achieving this option requires a definition of “geographic area”. Options to define geographic area are assessed by whether they:

- have clear and stable boundaries and is it well understood by those with an interest in the returns (e.g. societies, community groups);
- ensure that a high proportion of funding is returned to the communities that generated them; and
- enable societies some flexibility to determine the community with which they feel affiliated.

Options and impact analysis

51. The Department considered two main options for ensuring that a proportion of net proceeds are distributed in the same area where they were generated:

- Introduce new regulations that require societies to distribute a proportion of their net proceeds in the area they were raised; and
- Non-regulatory engagement with societies and communities to lift local rates of distribution.

⁸ Given the requirement for societies to distribute at least 37.12 per cent of their GST exclusive gross proceeds, this percentage has been calculated on the basis of the minimum level of what an area could reasonably expect to receive based on GMP in that area.

Preferred Option: introduce new regulations to mandate a minimum local rate of return

52. The preferred option is to introduce new regulations that require all societies to distribute a proportion of their net proceeds in the geographical area in which they were raised. Societies would calculate the percentage of local distribution based on the GMP that is raised in that area. This option is feasible as all Class 4 gaming machines are electronically monitored by the Department, enabling the collection of accurate data about where the money is generated. Further proceeds from things such as the sale of chattels will be distributed at a society's discretion.
53. This option will achieve the policy objective by creating a mechanism to ensure that a proportion of the proceeds from gambling are distributed to the area where it was generated. This option will require a definition of "geographical area" and a set percentage minimum of net proceeds to be returned to be established in regulations.
54. Two primary options were considered for the definition of a local area – territorial authority and regional council boundaries. During public consultation, there was stronger support for the territorial authority definition. Forty-nine per cent of submitters supported territorial authority boundaries, while 24 per cent supported regional boundaries. The majority of societies also supported a territorial authority definition.

Sub-option 1: A territorial authority definition of "local"

55. Despite the public support for a territorial authority definition of "local" the Department, based on its experiences as a regulator, does not support this option. A territorial authority definition of local would mean that both national and regional organisations would not be eligible for "local" grants. Some regional organisations would likely be forced to submit multiple applications for grant funding to societies based on territorial authority boundaries, reducing certainty and increasing compliance costs for both organisations and societies. Further, in some areas, Class 4 gamblers frequently travel across territorial authority boundaries (e.g. from city councils to surrounding district councils). As a result, some organisations may be unable to access funding despite the fact that many people from a neighbouring territorial authority frequently use services in their area.
56. Additionally, councils are required to develop Class 4 venue policies that may specify limits on the number of venues within their district. During consultation, some territorial authorities expressed concern that if "local" was defined at the territorial authority level some councils may come to see Class 4 venues as financial assets for their district, potentially influencing the development of their Class 4 venue policies in favour of increased gambling. However, the Department considers this unlikely, as councils are required to follow a transparent public process when changing Class 4 venue policies that includes consideration of both the negative and positive impacts of gambling.
57. Many rural territorial authorities have a very small number of venues and gambling machines (e.g. only 15 Class 4 venues are situated in the Central Otago district). This creates a risk that such areas may miss out on funding if they are not part of a wider neighbouring funding pool. This will be exacerbated if an increase in the minimum rate of return to authorised purposes reduces the number of rural venues.
58. Conversely, some societies have also indicated that a territorial authority definition will restrict them to a smaller pool of grant applicants, and result in increased administrative costs from having to deal with lower quality grant applications.

Preferred option – A regional council definition of “local”

59. A regional council area definition of “local” will allow societies more flexibility in choosing how to distribute their funding, potentially resulting in higher quality grant decisions. It also allows for larger community organisations that operate across territorial authority boundaries to more easily apply for grant funding, and gives rural areas access to a larger pool of funding. Finally, the broader definition of “local” will ensure national organisations will face less competition for the remaining funding not required to be distributed locally.

60. The primary downside of this option is that the broader definition of “local” means that there is less certainty that the geographic distribution of grants will match where funding was raised. As a result, within regions some districts may receive relatively low distributions of funding. However, further work on transparency discussed later in this regulatory impact statement may help to mitigate this problem. Further, the Department can continue to monitor the sector in order to assess patterns of distribution within regions.

61. The two main options are considered in the table below.

Table 3: Impact analysis of different options for ensuring a proportion of net proceeds are distributed locally

Sub-option	Assessment against criteria		
	<i>Impact: Stable, clear definition?</i>	<i>Impact: Ensure local return?</i>	<i>Impact: Allows flexibility?</i>
<i>Defining the “local area” as the territorial authority district</i>	<ul style="list-style-type: none"> High impact – boundaries clearly defined in legislation 	<ul style="list-style-type: none"> High impact – territorial authority areas are relatively small 	<ul style="list-style-type: none"> Low impact - societies constrained to granting funds in small area, with potential negative effects on grant quality and availability
<i>Defining the “local area” as the 17 regional council boundaries (preferred option)</i>	<ul style="list-style-type: none"> High impact – boundaries clearly defined in legislation 	<ul style="list-style-type: none"> Medium impact - regional council areas are large, and so there is a greater risk that funds will not be returned to the same community that generated them 	<ul style="list-style-type: none"> High impact - flexibility to make grants across wider area, helps to meet the needs of larger organisations and a wider variety of communities

Note, boxes shaded green indicate a positive impact, boxes shaded orange indicate a moderate impact and boxes shaded red indicate a negative impact.

Setting the percentage to be distributed locally

62. The regulations will need to specify a minimum rate of local return. An 80 per cent rate of return was the most popular option for submitters, and three quarters of submitters supported a rate between 70 per cent and 80 per cent.

63. Given the Department supports a regional definition of local, a higher percentage of net proceeds to be distributed locally is preferred. The larger the area considered to be local, the higher the minimum rate of distribution can be because societies retain greater flexibility for where they may grant funds.

Preferred option

64. The preferred option is that the percentage of net proceeds to be distributed in a particular region to be set at 80 per cent of net proceeds. Not only was this option the most popular amongst submitters, it also roughly corresponds to the Department's high level analysis of grant-making. This indicates that national organisations receive grants totalling approximately 21 per cent of net proceeds from Class 4 non-club gambling. Therefore, a local rate of return of 80 per cent should still leave sufficient flexibility to ensure that national organisations are not adversely affected.

Non-regulatory option to encourage increased local distribution

65. The Department also considered undertaking a programme of engagement and education with societies and community groups to lift local rates of distribution. For example, the Department has commenced work to encourage local distribution of Class 4 proceeds, starting with the Manurewa Local Board. In 2013, the Department held workshops with the sector to focus on the challenges societies face in distributing funds back to the area they are generated in.

66. While this programme will encourage societies to distribute more funding locally, rolling out this option nationally would be highly resource intensive, and the success of the initiative cannot yet be assessed. Further, it would not ensure that a high proportion of funding is returned to the communities that generated them (though it has the potential to increase the likelihood). The Department, therefore, does not support a non-regulatory option, though it will continue to work with societies and community groups to encourage local grant making.

Issues 3 and 4: Proposals to increase transparency and reform the venue payments system

67. The Department is also developing proposals to improve:

- the transparency of grants from Class 4 gambling; and
- the model for compensation of Class 4 gambling venues.

68. In-principle agreement from Cabinet is sought for further work on these matters. The preferred approach to reform at this time is to develop new regulations around transparency and venue payments. Such regulations will first require passage of the Gambling Amendment Bill (No 3), which amends the Act's regulation-making powers. A subsequent regulatory impact statement will be prepared to support any future Cabinet policy decisions on these matters.

Consultation

69. The Department received a total of 114 submissions for its public consultation document on options to reform the Class 4 gambling regulatory framework. Outcomes of the consultation were discussed earlier in the RIS.

Conclusions and recommendations

70. The preferred option for raising the proportion of gross proceeds distributed to authorised purposes is to amend the Gambling (Class 4 Net Proceeds) Regulations 2004 to increase the minimum rate of return to 40 per cent in year 1 (2014/15), 41 per cent in year 3 (2016/17) and 42 per cent in year 5 (2018/19). The preferred option will provide societies with sufficient time to adapt to the reforms, thereby mitigating against possible negative outcomes, whilst ensuring a higher rate of return in the long run.
71. The preferred option for ensuring that a proportion of net proceeds are distributed in the same area that they were generated is create new regulations, under section 114 of the Act, to mandate a minimum local rate of return. Local would be defined at the regional level and the minimum rate of local return would be set at 80 per cent of GMP raised in the region. The preferred option involves few risks and will ensure – at a high level – that grant funds benefits the communities that generated them.
72. In-principle agreement from Cabinet is sought for further development of new transparency requirements and a commission-based payment system, subject to the passage of the No 3 Bill.

Implementation

73. If Cabinet approves the preferred options, amendments will need to be made to the Gambling (Class 4 Net Proceeds) Regulations 2004. Societies will be notified in advance of the changes.
74. The Department and societies may need to adjust their current reporting mechanisms in order to meet the new transparency requirements. It is considered that the costs of this are likely to be low.
75. For the implementation of the new minimum rate of return, year 1 will be the first financial year after the regulations come into force. Societies currently all have different financial years. As a result, the effect of the increase will be staggered, and may not be fully identifiable for several years.

Monitoring, evaluation and review

76. The Department will actively monitor implementation of these proposals in order to evaluate the impacts of the changes. Monitoring will include ongoing analysis of the annual rate of return and the aggregate amount returned to authorised purposes. The Department will also assess the impact of the reforms via ongoing engagement with:
 - societies through regular regional forums; and
 - the community and voluntary sector through organisations such as the Association of Non-Government Organisations of Aotearoa.
77. If necessary, the Department will review the new minimum rate of return to authorised purposes and the local rate of return. The transparency proposal, if later developed as a part of the subsequent regulatory impact analysis, will help the Department to monitor the impact of the new local return regulations when it is implemented.