



**National Lottery
Commission**

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Response to Department for Business, Enterprise and Regulatory
Reform Consultation on a system of Regulatory Budgets

November 2008

**NATIONAL LOTTERY COMMISSION REPOSE
TO DEPARTMENT OF BUSINESS, ENTERPRISE AND REGULATORY REFORM
CONSULTATION ON A SYSTEM OF REGULATORY BUDGETS**

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1. Introduction

1.1 In 1993, Parliament passed The National Lottery etc. Act which set up a National Lottery together with its own dedicated regulator and a system of distributing its proceeds to specified good causes. The first draw was held on 19 November 1994 since which time more than £63 billion of tickets have been sold, over £29 billion have been paid out in prizes and more than £22 billion has been raised for good causes.

1.2 The National Lottery Commission ('the Commission') is the regulator of the National Lottery – sponsored by the Department for Culture, Media and Sport. It has specific statutory duties to exercise its functions in the manner most likely to secure:

- That the National Lottery is run with all due propriety;
- That the interests of players are protected; and
- Subject to the above two duties, that the returns to good causes are as great as possible.

1.3 The Commission welcomes the opportunity to respond to this consultation. It is of the view that its sponsor department and others are best placed to comment on the effect of regulatory budgets to the economy as a whole. However, it does have a specific response to make.

1.4 It is not yet clear what organisations would be included within the scope of regulatory budgets should they be pursued. The Commission welcomes the consultation stating that, *'...in practice, the Government will need to look at the specific situation of each regulator to determine its inclusion or otherwise.'* This is particularly important in the case of the Commission.

1.5 The purpose of the Commission's response is to clearly set out its views on the implications of including its own regulatory functions within a system of regulatory budgets.

2. Commission Response

The unique nature of the National Lottery and its regulation

2.1 In order to assess whether the Commission's functions should come within scope of regulatory budgets it is first necessary to understand the features of regulating the National Lottery that make it different to most, if not all, regulatory regimes.

2.2 The introduction of the National Lottery in 1993 established three important principles. First, the existing position that lotteries are unlawful unless specifically authorised by legislation was maintained. Second, it established that the National Lottery would be a means of raising funds for public benefit (through the 'good causes'). Third, it established that the National Lottery should be a monopoly, commercially operated but primarily for the public good. The Commission was created to oversee these arrangements and it was given its three important statutory duties – see above.

2.3 The Commission's obligations around *propriety* and *player protection* mean that it has to regulate Camelot plc, the commercial operator of the National Lottery, in a way that ensures that socially acceptable outcomes are met. For example, its obligation to protect the players of the Lottery requires that it must not license any game which, in its opinion, is likely to encourage excessive or underage play. It must therefore be satisfied that any game the operator proposes contains sufficient harm prevention measures before it will allow the game to go on sale. These sorts of activities are regulatory at heart but they have the unique characteristic that they must reflect the special status of the National Lottery – a commercial monopoly run primarily for the benefit of the nation.

2.4 The Commission grants a licence to operate the National Lottery through periodic competitions (Camelot plc were recently awarded the third licence which will run from February 2009 until 2019). This adds another feature that is unlike other regulatory regimes.

2.5 The Commission's relationship with the operator is, on major elements of the licence, akin to a *contractual* relationship rather than oversight of compliance. The regulatory regime that will be delivered through the third licence has been freely entered into, reflecting the terms of the recent competition. The licence itself therefore needs to be a substantial document as it incorporates both regulatory elements (e.g. to ensure the fair operation of draw machines) and commercial ones more akin to contractual terms (e.g. to safeguard in the long term the Commission's interest in Lottery intellectual property).

2.6 Also, regulation of the National Lottery is based around a specialist body to oversee a single operator, rather than overseeing matters which apply to a large number, if not all, businesses.

2.7 The Commission's three statutory duties provide the Commission with responsibilities which go beyond a simple regulatory role. Its duty to ensure that returns to good causes are as great as possible is different in nature to the other two. It requires the Commission to take on an *investor* role, acting on behalf of the national interest and the interest of the good causes. There are a number of strands to this role:

- Ensuring that licenses are granted in a way which, subject to player protection and propriety issues, deliver the most benefit for good causes;
- Satisfying itself that the commercial operator is performing as well as possible from the perspective of returns to good causes;
- Securing the longer term interest of the good causes – particularly returns beyond the current licence period.

2.8 These responsibilities are different from traditional regulation, and indeed unique to the Commission's regulatory regime. The relationship must recognise that the operator needs a significant degree of commercial freedom to bring its expertise to bear and respond quickly and innovatively to changes in market conditions. There is little benefit in seeking to double-guess the operator, or in substituting the regulator's own commercial judgements for those of the operator. This has been made possible by the alignment of incentives, whereby the operator's returns are closely tied to the returns it generates for good causes.

2.9 But, while promoting commercial freedom, the Commission also has to ensure that measures are in place to challenge under performance and secure the long term interests of the good causes. This recognises both the position of the Lottery operator as a monopoly supplier and therefore the absence of direct market competition to drive the operator's

performance, and the potential for divergence between the operator's overriding duty to its shareholders and the Commission's overriding duty to maximise returns to good causes.

2.10 Few other 'non financial' regulators are required in law to have a direct interest in the commercial success of the undertaking in which they regulate. Most regulators focus on compliance with a specific regime and will not be directly concerned with the effect that this will have on the business's finances. However, if the Lottery operator were to fail, returns to good causes would be lost as a consequence. The Commission therefore must ensure that the operator remains commercially viable.

3. Does the regulation of the National Lottery align with regulatory budgets?

3.1 It is clear that the Commission's duties do not simply slot straightforwardly within the scope of general regulatory policy. As a result the Commission must be sure to take a view on developments in government policy on regulation and whether it is proportionate for them to be applied to the operation of the National Lottery.

3.2 The Commission believes that the unique nature of its regulatory activity means that it would be inappropriate to include the National Lottery within the scope of regulatory budgets – akin to throwing an apple into a basket of pears. The Commission has been set up for a specific role with specific statutory functions. It would therefore seem inappropriate to treat them in the same way as other regulators who, although regulating a vast array of activity, do so in a similar manner.

3.3 There are additional reasons why the Commission believes that its functions should not be included within the scope of regulatory budgets, should they be pursued.

(i) The Government's main reasons for proposing regulatory budgets do not naturally apply to the National Lottery.

3.4 The Executive Summary to the consultation lists the Government's reasons for proposing regulatory budgets. As stated in the introduction, the Commission is not commenting on the validity of these, rather that they do not relate the National Lottery. The reasons over and above the current better regulation objectives are:

- There is a finite capacity for the economy to absorb the total cost of regulation and there is no mechanism for the Government to directly manage these costs;
- There is scope to improve both the way it prioritises new regulatory proposals and the way it manages the overall costs of regulation.

3.5 These reasons lend themselves to the control of regimes that apply to broad sections of the economy. As discussed earlier, the Commission oversees a single operator which has been selected for its expertise in lottery operations, much of which is a quasi contractual relationship. The Commission does not believe that the inclusion of its functions would contribute to the delivery of these objectives.

3.6 As the Commission has a statutory obligation to maximise returns to good causes, it therefore follows that there is a strong incentive for the Commission not to over regulate and that its regulation is outcome-based. This allows the operator greater commercial freedom which in turn will help to ensure the returns to good causes are maximised.

3.7 Similarly, as the Commission regulates a single entity, there is an expectation that the Commission will consult that entity before it makes any changes to the licence. There is clearly therefore a full opportunity for the regulated entity to relay to the Commission in a clear and transparent way the consequences of any regulatory change that the Commission proposes to introduce.

(ii) It is proposed to exclude certain regulators.

3.8 The consultation document states:

'...the Government would not intend to include competition functions and case specific remedies within the scope of regulatory budgets. The Government also proposes to exclude functions of economic regulators. The economic regulators have been established by statute with the explicit role of regulating a sector characterised by monopoly structures and market power.'

3.9 This is recognition that regulatory budgets are not suitable for all areas of regulatory activity. It is worth noting that the Commission's activity could reasonably be broadly compared with that of, say, Ofgem, more than it could the Health and Safety Executive.

4. Conclusion

4.1 In conclusion, the Commission is of the view that regulation of the National Lottery is not suitable for inclusion in a scheme of regulatory budgets for the following reasons:

(i) The Commission has been created with specific statutory duties to regulate a specialised regime with unique characteristics. It is not like other regulators and should not be treated as such;

(ii) Inclusion will not contribute to the Government's stated objectives.

(iii) It is already proposed to exclude other regulators with similarities around the regulation of a sector characterised by monopoly structures.

4.2 This response should not be interpreted to mean that the Commission does not accept that the ever evolving regulatory regime will apply to the National Lottery. The Commission is committed to the Government's better regulation agenda and has recently embarked on its *Regulating with Excellence (Rex)* programme¹. This is aimed at reviewing the Commission's regulatory approach in line with the principles of better regulation but while recognising the dual nature of the Commission's role.

4.3 This programme of work will contribute to the Government's wider better regulation strategy. The Commission's aim is that it operates in a way that secures the optimum performance from the operator and delivers the best possible outcomes for players and good causes, consistent with the maintenance of high standards of propriety and player protection. The Commission intends that this activity should not involve unnecessary burdens for the operator but should take account of past performance, whilst focusing on areas of risk.

¹ Specific workstreams on enforcement, outcome based regulation, earned autonomy, transparency and operator performance.

4.4 The Commission also aims to be fully transparent in its policy, decision making, and communication processes in order that it is a fully accountable regulator and its processes are clearly understood by its stakeholders. For example, this will be increasingly enabled through a published Enforcement Policy and further developments of reporting arrangements in the Commission's annual report.