



**National Lottery
Commission**

A Review of the National Lottery Commission's
Approach to Regulation

April 2006

Foreword

The National Lottery has proved to be remarkably successful – inspiring confidence in players and generating significant returns to good causes. At the Commission we are committed to delivering a healthy future for the National Lottery by looking forward and regulating positively.

This paper sets out our current thinking on how our approach to regulation might evolve. I hope it demonstrates that we are open-minded in our approach and determined to regulate in a way which enhances the development of the National Lottery without imposing unnecessary burdens which constrain or restrict its potential.

I am grateful to those organisations that have helped shape our thinking to this point. Within the paper we have expressed our own views, but we would welcome further comments and views from all stakeholders, in particular on implementing these principles in practice. I hope you will provide us with your views.

Dr Anne Wright CBE
Chair of the National Lottery Commission

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1 Introduction

The introduction of the National Lottery in 1994 was a significant opportunity to raise new funds for good causes, but it also provided the challenge of introducing effective and efficient regulatory arrangements. Government established the remit of the regulator, who was free to determine the approach to and model of regulation. This needed to reflect the particular circumstances that were in evidence when the National Lottery was launched; that is, a newly established operator, inexperienced players and an inexperienced regulator. It was extremely important that, whatever approach was taken, the key to the success of the National Lottery would be that it inspired confidence among players, and that its reputation would be unquestioned. The regulatory model was therefore designed to reflect the degree of risk that these circumstances posed. It was characterised by a detailed and prescriptive framework which was underpinned by the need for the operator to obtain consent or approval in advance of taking action.

There can be no doubt that this approach has proved very effective and confidence among players and other stakeholders is positive. Over time the approach has evolved and the current arrangements are set out in section 2.

The Commission must continue to achieve a balance between ensuring that it has control over the operation of the National Lottery, while enabling the operator to exercise the commercial judgement and ability for which it has been awarded its licence. The challenge is to ensure that the regulatory arrangements the Commission has established provide for the optimum performance by the operator.

The Commission is aware that the regulatory environment and context within which it operates is evolving and is committed to ensuring that it reflects the best practice emerging from these changes. There is an expectation that regulators will routinely assess the effectiveness and efficiency of their arrangements. It is therefore appropriate to take the time to step back and review whether the current arrangements continue to be appropriate and to look ahead to how the Commission might need to respond and evolve its approach. In doing so the Commission is mindful of the need to renew its focus on the costs of regulation while securing improved outcomes for the National Lottery.

The Commission is currently running the competition process to decide who will operate the National Lottery when the current licence expires in 2009. As noted, the Commission recognises that the regulatory context in which it operates is evolving and will continue to do so during the course of the current and next licence periods. This paper is intended to set out the Commission's approach to regulation going forward and, as such, it should be considered to be complementary to the competition process.

The Commission welcomes comments on the proposals in section 4 from all those with an interest in the National Lottery, including players and potential bidders for the next licence. The Commission will publish a summary of responses and its final conclusions.

2 The Current Legal and Regulatory Arrangements

The Objectives of the Commission

The statutory duties of the Commission are set down in the National Lottery etc, Act 1993, as amended. These are that the Commission must:

- ensure that the National Lottery, and every lottery that forms a part of it, is run with all due propriety;
- ensure that the interests of every participant in the Lottery are protected; and
- subject to these two duties, do its best to maximize the proceeds of the National Lottery.

The Commission's mission is:

“ We will regulate the lottery so as to ensure that players are treated fairly, protect the nation's interest in the lottery and motivate the operator to maximise the enjoyment and benefits that the lottery brings to the nation.”

The Commission will consider whether the outcome of this review suggests that its mission requires updating.

The main rules which relate to the operation and regulation of the National Lottery are set out in:

- The National Lottery etc Act 1993 (the "1993 Act").
- The National Lottery Act 1998 (the "1998 Act").
- Various Statutory Instruments of which The National Lottery Regulations (the "Regulations") is the most relevant.
- The licences issued under Sections 5 and 6 of the 1993 Act.
- Directions issued under Section 11 of the 1993 Act by the Secretary of State for Culture, Media and Sport (the "Directions").

The legislation provides for a range of sanctions for non-compliance with licence obligations. Under section 9 of the National Lottery Act 1993, the Commission may apply to the High Court for an order requiring the licensee to remedy a contravention, or possible contravention of the licence. Under section 10, the Commission shall revoke a licence granted under section 5 where the licensee no longer is, or never was, a fit and proper body to run the National Lottery. Furthermore, it may revoke the licence if it appears that any of the grounds set out in Part 1 of Schedule 3 applies. Under section 10A of the Act (as amended), if the Commission is satisfied that a person has contravened a condition in a licence under section 5 or 6, it may impose a financial penalty on that person in respect of the contravention.

3 The Regulatory Context

There is a significant body of work which aims to improve the quality of regulation. This section highlights some of the most important elements of that work from the Commission's perspective, but does not seek to present a complete summary.

3.1 The principles of good regulation

The Better Regulation Task Force and its successor bodies have articulated five principles of good regulation. These are now widely accepted and endorsed by regulators. The Commission takes account of these principles and attempts to apply them to all aspects of its work.

The principles are defined as¹:

- Proportionality: regulators should only intervene when necessary. Remedies should be appropriate to the risk posed and costs identified and minimised.
- Accountability: regulators must be able to justify decisions and be subject to public scrutiny.
- Consistency: Government rules and standards must be joined up and implemented fairly.
- Transparency: regulators should be open and keep regulations simple and user-friendly.
- Targeting: Regulation should be focused on the problem and minimise side effects.

3.2 Risk-based regulation

A risk-based approach to regulation has been proposed as one of the solutions to some of the potential problems of regulation, such as a tendency towards more regulation than is necessary, inflexibility about its implementation and unnecessary or unjustified cost. Regulators have responded to this agenda in different ways. Some have published formal frameworks which provide a broad perspective, setting out how they will assess and respond to risk within their markets; others have employed a series of risk-based tools to their decision taking.

3.3 Monitoring performance and enforcement

The Hampton Review² was primarily concerned with regulation as it impacted upon whole sectors, specific industries and small businesses. However, it set out a number of principles for regulatory enforcement which are of broad relevance. Hampton suggested that the regulatory system should move towards these goals:

- Regulators, and the regulatory system as a whole, should use comprehensive risk assessment to concentrate resources on the areas that need them most;
- Regulators should be accountable for the efficiency and effectiveness of their activities, while remaining independent in the decisions they take;
- All regulations should be written so that they are easily understood, easily implemented, and easily enforced, and all interested parties should be consulted when they are being drafted;
- No inspections should take place without a reason;
- Businesses should not have to give unnecessary information, nor give the same piece of information twice;

¹ Regulation – Less is More, Better Regulation Task Force 2004

² Reducing Administrative Burdens: effective inspection and enforcement. Philip Hampton, March 2005

- The few businesses that persistently break regulations should be identified quickly and face proportionate and meaningful sanctions;
- Regulators should provide authoritative, accessible advice easily and cheaply;
- When new policies are being developed, explicit consideration should be given to how they can be enforced using existing systems and data to minimise the administrative burden imposed;
- Regulators should be of the right size and scope, and no new regulator should be created when an existing one can do the work; and
- Regulators should recognise that a key element of their activity will be to allow, or even encourage, economic progress and only to intervene when there is a clear case for protection.

3.4 Applying sanctions

Hampton identified that the application of sanctions should provide both a deterrent to non-compliance and an incentive to comply with regulations and that sanctions are therefore an important tool in securing regulatory objectives. The Better Regulation Executive has recently published a paper setting out the terms of a review of regulatory justice³. This is seeking to establish whether the range of regulatory sanctions is as effective as it could be and whether the tools available command both public and business confidence.

3.5 Regulatory impact assessments

Regulatory Impact Assessments (RIAs) have been introduced by many Government departments to assess the potential outcomes of regulatory decisions. This is in order to achieve a balance between under-regulating, which may fail to protect the public, and over-regulating, which may cause unnecessary administrative costs. RIAs are intended to inform the policy making process and communicate clearly the objectives, options, costs, benefits and risks of proposals to increase the transparency of the process.

3.5 Modernising delivery

The Department for Culture, Media and Sport Business Plan 2005, reflects the range of issues set out above; specifically, it refers to efficiency and value for money within its strategic objectives and priorities.

³ Better Regulation Executive. Regulatory Justice: Sanctioning in a post-Hampton world

4 Evolving the Commission's Approach: Responding to the Agenda

The National Lottery Commission is unusual in that it has a one-to-one relationship with the operator of the National Lottery and has a direct interest in its financial viability. There are few direct parallels with other industries, which generally have elements of competition or are organised within regions. For the Commission this poses some challenges, not least because it lacks a direct way of comparing performance.

4.1 Risk

The Commission routinely considers risk in making decisions and in discharging its responsibilities. In doing so, it pays particular attention to its statutory duties, considering the impact of decisions on the propriety of the National Lottery and the interests of players, while seeking to ensure that the maximum returns are secured for the good causes. In assessing risk, it takes into account its experience and knowledge of the range of issues which have an impact on the National Lottery. The Commission however, has not done so with the benefit of a formally defined risk assessment structure or in a way that is always transparent to the operator or other stakeholders. The Commission recognises that it could make improvements in both respects.

The Commission proposes beginning work to develop a formal framework for assessing risk. Such a framework will seek to reflect and weight the different expectations and interests of stakeholders and will be established following a formal consultation exercise. When this has been completed, it will be applied to the range of the Commission's work, with the intention of ensuring that the Commission continues to regulate proportionately.

It is expected that the assessment of risk will take account of the full range of factors which impact upon the National Lottery. For example, it will take account of the experience of the operator and the changing nature of the wider gambling market, including the development of new sales channels. The Commission will base its assessment of risk on a firm evidence base; for example, it will be informed by research undertaken by the Commission into player knowledge and behaviour. Summaries of this research can be found on the Commission's website at www.natlotcomm.gov.uk

Regulation in practice

In the past, the Commission has addressed the need for transparency to players of the terms and conditions under which they participate in National Lottery games by requiring this information to be on display at retailers. More recently this has been available on request from retailers. However, there is a cost associated with doing so, both in supplying up-to-date information and ensuring that retailers are responding to player requests. There are also risks that players may be given out of date information. Modernisation of distributions channels means that there is an opportunity to review alternative ways of providing such information, for example electronically. Review of these alternatives could be made with reference to a risk framework, which would enable a full consideration of the impact on players, retailers and the operator.

Proposal 1: The Commission will establish a formal evidence-based framework for assessing risk, which it will apply to the range of its work to ensure that it continues to regulate proportionately.

4.2 The regulatory model

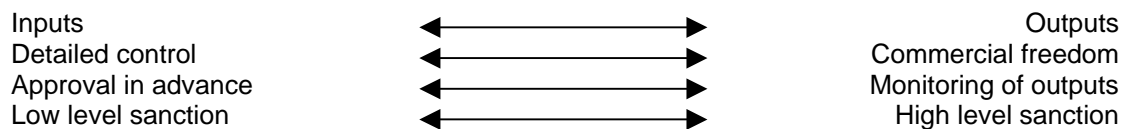
The Commission has sought to develop and evolve its approach to regulation by focusing on the objectives and outcomes of its decisions. The Commission distinguishes between its 'social' regulation responsibilities, such as the prevention of underage or excessive play, and its 'commercial' regulation responsibility to maximise returns to good causes. In some

commercial areas it has attempted to move away from the detailed control of inputs, which require consent or approval in advance. For example, it has moved away from the licensing of individual scratchcard and interactive instant win games and now grants class licences. These allow the operator to launch certain types of games, within prescribed guidelines, without prior consent from the Commission. Unusual or complex games, which may have a more significant impact upon player protection, continue to require individual licences.

The Commission wishes to continue to move towards the regulation of outputs, and away from the detailed regulation of inputs, where it is appropriate to do so. It believes that in doing so it will provide the operator with the most beneficial environment in which to exercise its commercial judgement. In proposing this, the Commission understands that there will be other impacts upon the operator, in particular reduced certainty in complying with its regulatory responsibilities. The Commission however, expects that this will result overall in a positive benefit in returns to good causes.

The Commission recognises that such an approach must be managed closely and carefully to ensure that its broader responsibilities in respect of propriety and player protection are not compromised.

The extremes of the model are set out in the diagram below:



The Commission does not intend to move from one extreme to the other. Rather, it believes that it can continue to evolve its approach so as to adopt controls which are proportionate to the outcomes it is seeking. It proposes to begin by identifying areas in which such an approach could be developed with the minimum of risk to the National Lottery and to players. It will work with stakeholders, including the operator, to develop and define outputs which provide for an appropriate level of performance and which can be effectively monitored. In doing so, it would expect to provide the operator with greater commercial freedom, but would seek to balance this with the application of firmer sanctions for non-compliance.

Regulation in practice

In order to ensure that the National Lottery is run with all due propriety, the Commission currently undertakes an extensive programme of checking certain categories of employees of the operator and its contractors. This is an input control. In moving towards the regulation of outputs, the Commission could set a general requirement about the expected integrity of the operator's staff, but not specify how this must be assured. This would encourage the operator to take full responsibility for its own staff and to exercise its judgement in the appointments it makes. It would have greater control over its appointment of staff, but would bear a greater proportion of the risk of so doing. Failure to adopt and apply effective controls as part of its appointment processes would result in a proportionately more significant sanction than exists at present.

Proposal 2: The Commission will work with its stakeholders, including the operator, to identify opportunities to relax its regulation of regulatory inputs and define appropriate outcomes which can be measured and enforced.

4.3 Principles of good regulation

The Commission, while independent, is formally accountable for its actions.

- It is a non-departmental public body ("NDPB"). It has accountabilities to its parent department (DCMS) through its Management Statement and Financial Memorandum. The Chief Executive is its accounting officer and has personal accountabilities to Parliament.
- It is accountable to Parliament. It may be called to appear before Parliamentary Select Committees (especially the Select Committee for Culture, Media and Sport) and the Accounting Officer may be called to appear before the Committee of Public Accounts.
- It is required to produce an annual report and statement of accounts, which is audited by the National Audit Office and laid before Parliament prior to publication.
- The Secretary of State is responsible for appointing the Commissioners and may, in certain circumstances, remove them from office. The Commission must exercise its functions in accordance with the relevant legislation and directions made by the Secretary of State.
- Commissioners must act in accordance with the Commission's code of conduct for Commissioners.
- The Commission publishes a range of information about its work and policies, and is able to publish the decisions it makes where it considers it in the public interest to do so. The Commission is subject to the Freedom of Information Act.

The Commission seeks to regulate proportionately. This will not always mean with a 'light touch', but rather to regulate only where necessary, targeting its efforts and resources where they are most needed and will have most effect. The impact of this approach will be strengthened by the proposal to develop a framework for the analysis of risk.

The Commission attempts to ensure that its methods and approach are consistent with other regulators and takes account of best practice. It has both formal and informal links with other regulators; for example, it has established a formal relationship with the Gambling Commission, which has responsibility for regulating the wider gambling industry. The Commission continues to explore ways in which it can develop links with other regulators to address generic areas of interest.

The Commission routinely publishes information about its performance and work. However, it recognises that, with increasing public interest in the National Lottery, it could provide greater transparency of its routine decisions and the reasons for those decisions. The Commission is committed to improving transparency wherever possible. It intends to review its approach to publication of information and proposes that all of its decisions and the reasoning behind those decisions should be published unless there is a sound reason not to do so. In taking this approach, the Commission will be mindful of the need to protect the position of the National Lottery, which operates within the context of a developing market for gambling products, and the need to respect the commercial position of the operator. The Commission will also consider the appropriate timing of publication; some of its decisions, for example, may be commercially sensitive at the time they are made but may be appropriate for public reporting at a later date.

Regulation in practice

The Commission currently does not publish the full range of its routine regulatory decisions. It could publish (at the appropriate time), on its website a register of operator applications (for example for game licences) with the Commission's decision on the matter and its reasons for the decision. In recognising that some information will be commercially sensitive when decisions are made, the Commission would expect that, with the passage of time, they may become less commercially sensitive and therefore suitable for publication.

Proposal 3: The Commission will adopt a clear policy for publication of its regulatory decisions and set out its plans for improving the transparency with which it fulfils its responsibilities.

4.4 Inspection and enforcement

Although outside the scope of its review, the Commission has noted the recommendations of the Hampton report and is considering ways in which it can reflect the principles for regulatory enforcement.

Taking into account that several recommendations appear to be targeted at those organisations regulating in multi-firm or cross-industry environments, the Commission believes there is much from the Hampton review that applies to the regulation of the National Lottery. The Commission's approach has focussed on detailed monitoring of the operator's compliance with its licence obligations. It proposes reviewing that approach and considering whether it remains appropriate or whether there are areas in which it could reduce or re-direct its efforts. It is expected that as the Commission moves towards the greater regulation of outputs, this will need to be reflected in the Commission's approach to monitoring compliance and performance. In this way, the Commission will ensure that it is targeting resource where it is most needed, while minimising administrative costs for the operator.

Where possible, and if the review indicates that a reduction of inspections is appropriate, the Commission will re-direct resources by proactively providing advice and support to the operator to secure licence compliance. The Commission proposes to work closely with the operator in developing this approach. However, it recognises that such a change will require careful management and control to ensure that statutory responsibilities continue to be fulfilled. The Commission will work with other regulators to ensure that it understands how best practice is developing. It will also consider how the principle of 'earned autonomy' could be applied; that is, reducing supervision to reflect a good track record of performance.

The Commission regularly reviews the scale and scope of the information that it requires the operator to report to it, to ensure that it is proportionate to our remit. It will continue to do so with a view to minimising the costs that this imposes on the operator.

Regulation in practice

The Commission receives a copy of a case file each time Camelot exercises its discretion to decide to make a prize payment for a lost, stolen or damaged ticket. Each one is checked to ensure that the decision complies with the licence requirement. It would be possible to reduce the frequency of these checks, by focusing on those which represent the highest risk.

Proposal 4: The Commission will review its approach to monitoring compliance and performance, to ensure that its resource continues to be targeted appropriately.

4.5 Applying sanctions

The Commission recognises that the application of the sanctions available to it is an important element of securing compliance with licence conditions and achieving its regulatory objectives. It also recognises that the use of sanctions has a significant impact on the operator and is committed to using its powers in a way that is fair, proportionate and transparent. To this end the Commission is reviewing the range of sanctions it has available to it and the way in which it applies these. It is expected that implementation of the other proposals contained in this report will impact upon this work. For example, a move towards a greater focus on outputs is likely to require a different approach to sanctions.

Further, the Commission will contribute to the work being done by the Better Regulation Executive to review sanctions in a broader context.

Regulation in practice

The Commission has a process for dealing with non-compliance with licence obligations, which does not permit for resolution by informal means. The process could be amended to provide for informal resolution when the circumstances permit; for example, in cases of minor non-compliance by accepting an undertaking from the operator to comply in the future.

With a move towards the regulation of outputs there may be less clarity about whether objectives have been met. The Commission believes that there is the scope to require the operator to commission third party (expert) reviews of its performance where the Commission has concerns that its regulatory objectives may not be being met. The outcomes of such reviews would be reported to the Commission, as well as the operator. This would have the benefit of providing a greater understanding of the reasons for under-performance while still enabling the operator to act upon the results of the review.

Proposal 5: The Commission will review its application of sanctions for non-compliance and publish the outcome of that review.

4.6 Regulatory impact assessments

The Commission has not made direct use of regulatory impact assessments. However, those completed by the Department for Culture, Media and Sport have informed and shaped the development of the Commission's policies. The Commission has established mechanisms for obtaining views on major policy developments, but accepts that the framework associated with RIAs might well provide a more formal structure for achieving this in future. Going forward, the Commission intends to consider how it can integrate regulatory impact assessments into the process for making significant policy decisions, both to inform and challenge policymaking.

Regulation in practice

Significant developments such as the introduction of new sales channels could be subject to the RIA process. This would provide for an open and transparent consideration of the relative merits of such a proposal; for example, the balance to be struck between the benefits to players of improved access on the one hand, and the potential risk to players who may have a propensity to participate excessively on the other.

Proposal 6: The Commission will consider how it can best integrate regulatory impact assessments into its policy making process in a manner which adds value, but does not lead to undue delays in regulatory decision making.

5 Next steps

5.1 Views are invited

The Commission welcomes views from all interested parties on the proposals contained in this paper. Respondents are asked to respond to the approach set out and specifically on the proposals set out below:

Proposal 1: The Commission will establish a formal evidence-based framework for assessing risk which it will apply to the range of its work to ensure that it continues to regulate proportionately.

Proposal 2: The Commission will work with its stakeholders, including the operator, to identify opportunities to relax its regulation of regulatory inputs and define appropriate outcomes which can be measured and enforced.

Proposal 3: The Commission will adopt a clear policy for publication of its regulatory decisions and set out its plans for improving the transparency with which it fulfils its responsibilities.

Proposal 4: The Commission will review its approach to monitoring compliance and performance, to ensure that its resource continues to be targeted appropriately.

Proposal 5: The Commission will review its application of sanctions for non-compliance and publish the outcome of that review.

Proposal 6: The Commission will consider how it can best integrate regulatory impact assessments into its policy making process in a manner which adds value, but does not lead to undue delays in regulatory decision making.

5.2 Responses and timetable

Responses to this paper should be submitted by 19 July 2006. We would prefer to receive responses by e mail to:

l.crake@natlotcomm.gov.uk

If you would prefer to post your response, please send it to:

Louise Crane
Review of Regulatory Approach
The National Lottery Commission
101 Wigmore Street
London W1U 1QU

Please note that all responses will be made public or published in a summary of responses, unless you state clearly that you wish your response to be treated in confidence.

A summary of responses is expected to be published during September 2006.