

Gambling Commission response: What next for the National Lottery

September 2021

1 Executive summary

- 1.1 Since its launch in 1994, the National Lottery has raised more than £43 billion for 635,000 good causes, transforming lives through its contribution to the arts, sport, heritage and communities up and down the UK.
- 1.2 The Gambling Commission is the UK's independent, statutory body responsible for awarding the licence to run the National Lottery and tasked with regulating it to ensure propriety, the maximisation of returns to good causes, and safe and fair play. Subject to implementation of an extension, the third National Lottery licence is due to expire in 2024 and the Gambling Commission is running the competition to award the next licence.
- 1.3 The environment for the National Lottery has changed since the third licence began. To ensure that it remains relevant and attractive to all parts of society, there will be changes to how the National Lottery is licenced and regulated under the next licence. We have adopted an outcome-focused, risk-based and evidence-led approach to the fourth licence. This will allow the next operator more freedom to innovate while giving them greater ownership and responsibility for performance and delivery of the licence. A new incentive mechanism will align the operator's incentives more closely with maximising returns to good causes and there will be a robust regime to monitor performance.
- 1.4 Prior to the launch of the fourth National Lottery licence competition, the Gambling Commission undertook extensive market and stakeholder engagement to ensure we designed a competition that maximised the likelihood of attracting suitable applicants for the licence and minimised the potential disruption of either a failed competition or a successfully challenged competition.
- 1.5 The fourth National Lottery licence competition launched in August 2020. Phase One applications were received in April 2021 and Phase Two applications are due in October 2021. We intend to announce the preferred applicant in March 2022. We are pleased to have a competitive number of applicants and are confident that we are on track to fulfil our objectives for the competition and operation of the fourth licence.
- 1.6 The Gambling Commission has a strong track record of safeguarding the National Lottery and ensuring that it is run with integrity, protects players and maximises contributions to good causes. We are building on this success and continue to run a fair and transparent competitive process that provides opportunities for innovation and creativity while protecting the unique status of the National Lottery.

2 Introduction

- 2.1 The Gambling Commission is the UK's independent, statutory body responsible for awarding the licence to run the National Lottery. It is also tasked with regulating the National Lottery to ensure propriety, the maximisation of returns to good causes, as well as safe and fair play. We regulate the National Lottery under the National Lottery etc. Act 1993 and regulate commercial gambling in Great Britain in accordance with the Gambling Act 2005.
- 2.2 There have been three competitions for the licence to run the National Lottery. The Office of National Lottery (OFLot) ran the first licence competition, and the National Lottery Commission ran the second and third.
- 2.3 Subject to the implementation of an extension to the third licence, as announced on 4 August 2021, the current licence is due to expire 31 January 2024. Our role is to run the fourth National Lottery licence competition and, subsequently, regulate the next licence.
- 2.4 Given that the competition to award the licence remains underway, we have confined our responses to background information on the competition and the formulation of the fourth licence.

Fourth licence background

- 2.5 The regulatory and market environment for the National Lottery has evolved since 2009, when the third licence was awarded. The Gambling Commission now takes, in line with best practice, an outcomes-based approach to regulation. There have also been significant changes in the market, for instance, through the increasing dominance and rapid evolution of technology-based products. The Gambling Commission engaged with DCMS and other stakeholders, undertook extensive research and incorporated recommendations from the Public Accounts Committee to develop a new licence that will meet our statutory duties, the Government's objectives, and public expectation in the evolved environment.
- 2.6 There will be changes to how the National Lottery is licensed and regulated under the fourth licence, bringing it into line with the Gambling Commission's commitment to be an evidence-led, risk-based and outcomes-focused regulator (Annex A). The licence has been designed to enable the next licensee to continually adapt its operations to meet the needs of players in 2024 and beyond, while at all points requiring any development to be carried out in a safe and responsible way. More information on how this will be achieved is detailed in section 4.
- 2.7 The licensee will be held fully accountable for protecting players. Through the competition process, the successful applicant will have demonstrated high standards of player protection, commensurate to its games offering, including on prevention of underage or excessive play, and we will hold them accountable for their commitments during the licence period. We will retain strong enforcement powers and will use them, if necessary.
- 2.8 Key changes in the fourth licence include:
 - i. Focusing on outcomes: Under the outcomes-focused regulatory model, the Commission will be less involved in day-to-day operations of the National Lottery, such as approving processes, or reviewing the licensee's commercial decisions. Instead, the licensee will take on greater responsibility for compliance with its obligations. The Commission will continue to monitor performance and react if, and when, there are concerns that the licensee is failing to meet the terms of its licence. The proposed regulatory model is based on learnings from the third licence, as well as wider regulatory best practice. This includes, for example, the Cabinet Office's Regulatory Futures Review, which recommended that, where possible, regulators adopt an outcomes-focused approach.

- ii. Incentive mechanism: A new incentive mechanism will ensure the licensee's incentives and delivery are closely aligned with contributions to good causes.
- iii. Protecting the brand: Recognising that the National Lottery is a national asset, the licensee will be required to do everything it can to safeguard and promote the reputation of the National Lottery, as well as the value, integrity and strength of the National Lottery brand.
- iv. A fixed 10-year licence: A fixed term means that the licensee has a clear period for investment planning.

Competition background

- 2.9** In November 2018, the Commission formally commenced the market engagement phase of the programme. Throughout the following 18 months, we spoke to businesses and investors from many different sectors, such as communications and media, to hear the best and most innovative ideas to take the National Lottery forward in the next stage of its journey. Furthermore, we conducted research into overseas lottery markets to learn what opportunities could be harnessed in the design of the fourth licence.
- 2.10** A draft-version Invitation to Apply (ITA), licence, and accompanying documents were made available to the market in December 2019. This was the final full phase of market engagement and an opportunity for interested parties to provide feedback on the draft documentation.
- 2.11** The Selection Questionnaire (SQ) was issued to potential applicants in August 2020, marking the launch of competition. The SQ assessed whether, at that stage of the competition, the proposed licensee possessed the relevant professional and technical capacity and capability, as well as the financial and economic standing, to run an operation of the scale and complexity as the National Lottery. Applicants successful at SQ stage were subject to Fit and Proper Checks, to further ascertain their suitability. They also received the final ITA, including the licence, and supporting competition documents.
- 2.12** The ITA set out the National Lottery opportunity, together with the process and requirements associated with submitting an application, and information as to how applicants are to be evaluated. It is split into Phase One and Phase Two. A phased approach, with no applicants being removed from the competition at Phase One, was selected to provide applicants the opportunity to obtain feedback on the strengths and weaknesses of their application, and areas for improvement, ahead of submitting their final application at Phase Two.
- 2.13** A large portion of the competition has taken place amidst the Covid-19 global pandemic, an issue which has posed challenges for all organisations, both within the public and private spheres. During this period of high uncertainty, we have taken every step possible to ensure a fair, open and robust competition for all applicants.
- 2.14** The third National Lottery licence permits two six-month extensions to the licence. Since launching the competition, we have utilised both provisions to accommodate necessary changes to the competition timeline:
 - i. May 2020: Having considered the market's feedback on the challenges posed by the Covid-19 global pandemic, we decided to delay the launch of the competition by three months. To facilitate these changes, and ensure a smooth transition, we also added three months to the transition period and, subsequently, extended the third National Lottery licence by six months. During this period of high uncertainty, the extended timetable was designed to enable potential applicants to make adequate preparations for a fair, open and robust competition.
 - ii. August 2021: We extended the timeline for Phase Two of the competition, following representations from applicants and experience from Phase One. The amended timeline will see four weeks added to the Phase Two application stage and a further six weeks for evaluation. These changes will provide an opportunity for applicants to

further refine their proposals and for the Commission to evaluate. To facilitate these changes, and ensure a smooth transition, we intend to extend the third National Lottery licence by a further six months. Applicants and the current operator have been notified of this.

Despite these challenges, interest in the competition, and the fourth licence, has remained encouraging throughout the process.

2.15 Interested parties are currently preparing their Phase 2 applications, which are due by 15 October 2021 and will then be evaluated.

2.16 We aim to announce the preferred applicant in March 2022.

3 How effectively has the fourth National Lottery licence competition fulfilled the Gambling Commission's objectives?

3.1 As part of our responsibility as a regulator, we have three overriding statutory duties. These statutory duties are the 'cornerstone' objectives for the competition:

- i. Ensuring the National Lottery is run with due propriety
- ii. Ensuring that participants' interests are protected, and
- iii. (Subject to the previous two duties) doing our best to ensure the proceeds from the National Lottery are as great as possible.

3.2 As referenced above, the regulatory and market environment in which the National Lottery operates has changed since the start of the third licence. The Gambling Commission, in consultation with DCMS and other stakeholders, developed the fourth licence and the fourth licence competition to ensure that the above statutory duties will continue to be met under the new environment of the fourth licence.

3.3 In addition to the Commission's statutory duties in regard to the National Lottery, there are also programme objectives as agreed with DCMS:

- i. Ensuring high standards of propriety
- ii. Delivering a strong focus on player protection
- iii. Maximising returns to good causes
- iv. Shaping a robust and fair competition that delivers an 'outcomes-based' licensing regime
- v. Growing the value of the National Lottery as a public asset
- vi. Delivering a transition that is well planned and without disruption to the National Lottery
- vii. Engaging with key stakeholders

3.4 Our job is to run the best competition we possibly can – one that is open and fair and results in the best outcome for players and good causes. We want to appoint a licensee that can build on the National Lottery's legacy and find new opportunities for a sustainable and successful future. We are pleased by the progress of the competition to date and the competitive number of applicants, which reflects the strength of the competition.

3.5 Since launching the programme, we have implemented a range of measures to ensure all applications are assessed in a fair and objective way, minimising the possibility of any party gaining a material advantage.

Examples of these measures include:

- i. Licence design: Our outcomes-based approach opens up the market, as applicants are not required to follow a similar approach to the current operations and have the freedom to propose new solutions, so long as statutory duties are met

- ii. Media and communications protocols: A set of protocols provide guidance to all applicants on how they should engage the media and stakeholders during the course of the competition
- iii. Availability of data: A virtual data room provides all applicants with equal access to all relevant documentation. Furthermore, interested parties were consulted on required content during the market engagement phase.

4 What will the way in which returns for good causes are calculated under the fourth licence mean for the distributing bodies and the projects they support?

- 4.1 Since launching in 1994, National Lottery players have collectively raised more than £43 billion for 635,000 good causes across the UK, transforming lives and contributing to the arts, sport, heritage and communities.
- 4.2 While the Gambling Commission is responsible for managing the licence competition, and regulating the National Lottery, the distribution of generated funds is separate. This is carried out by independent distribution bodies, overseen by the Department for Digital, Culture, Media and Sport (DCMS) and the devolved administrations.
- 4.3 In 2018, the House of Commons' Public Accounts Committee concluded an inquiry into the National Lottery. This was followed by a number of recommendations, which have already been addressed by DCMS, the Commission, and the current operator for the purpose of the third National Lottery licence. As referenced, the lessons learned from the Committee's report were embedded across our policy work during the design of the fourth licence.
- 4.4 The next licensee will be required to foster stronger relationships with the distributors of National Lottery funding to further strengthen the link between the brand, its players, and good causes. We will also require the licensee to report regularly against key performance indicators to demonstrate the performance of the National Lottery brand.
- 4.5 We will build on the National Lottery's success through a restructured incentive mechanism that will ensure the licensee's incentives and delivery are closely aligned with contributions to good causes. The licensee will, therefore, be incentivised to develop and grow National Lottery sales and, thereby, its own returns and the contribution to good causes.
- 4.6 Recognising that the world is likely to be very different by the time the fourth licence concludes in 2034, we have designed the licence in such a way that it will enable and incentivise the licensee to adapt, in a safe and responsible way, according to technological advancements, new opportunities, and changes in consumer preferences. The new incentive mechanism will address criticism of previous models by not differentiating good causes contributions based on game type, thereby, making the licence more adaptable to changing consumer trends.

5 What needs to happen to ensure a smooth transition between the third and fourth licence period?

- 5.1 A smooth and successful transition from one licence period to the next will ensure continuity of the National Lottery, while also minimising disruption to participants and good causes. We have advised applicants to expect an implementation period of around 22 months to allow time for a smooth and successful transition. Applicants are drafting their submissions based on this assumption.

- 5.2** The transition period will be a transformational programme of work that will enable us to proactively build a trusting, and cooperative, relationship with the next licensee. We have devised a strategy for managing the transition period that sets out:
- i. The contractual arrangements for managing the transition period (the Enabling Agreement and the Cooperation Agreement)
 - ii. Our risk appetite and risk management approach
 - iii. The level of oversight we will require to gain the requisite levels of assurance that the transition is being delivered in accordance with our objectives
 - iv. Governance arrangements
 - v. Reporting requirements (key performance indicators, monitoring and oversight)
 - vi. Resourcing arrangements
 - vii. Contingency arrangements

During this time, the next licensee will provide the Commission with regular status updates, testing and assurance activities and milestone reporting. It will attend regular operational and strategic governance forums to assure the Commission that it is undertaking all necessary activities for ensuing a successful migration of the National Lottery operations and its ability to commence the fourth licence.

This structure allows us to work with the next licensee and its senior management to build confidence that all parties are ready to start the licence and move into an outcome-focused licence regime.

Co-operation agreement

- 5.3** The third licence contains extensive provisions for assets to transfer to a new licensee. The current and next licensee are required to enter into a Co-operation Agreement, along with the Commission, to ensure data, information and processes are exchanged in a timely, open and transparent manner to ensure an orderly handover of National Lottery assets, services, infrastructure and products. The agreement has been signed by the current licensee and the Commission. The successful applicant will be required to enter into the agreement ahead of the implementation period.

Enabling agreement

- 5.4** The core framework that shapes, and governs, the implementation period is the Enabling Agreement. This agreement takes the form of a commercial supplier/contractor contract and assists both parties in transitioning between licences. It creates a rigorous framework for a well-structured transition, with governance and reporting requirements that assure us that the transition is being delivered effectively, and on time. It will identify all key deliverables from the successful application and will align with its transition plan to deliver all elements by the start of the fourth licence.
- 5.5** We will enter into the Enabling Agreement with the preferred applicant. Fulfilling the requirements of the agreement will be a condition of the transfer of the National Lottery operation, and the commencement of the next licence. The agreement will be in place for the entirety of the transition period and will cease once the fourth licence comes into effect.

Transition team

- 5.6** A dedicated transition team has been established within the programme, separate from the fourth licence competition team. This team is responsible for:
- i. Managing and overseeing the transition from the third licence to the fourth licence
 - ii. Ensuring that the Commission is ready to regulate the fourth licence i.e. that it has the right resources, processes and systems in place for the duration of the licence.

The third licence team will remain focused on maintaining the National Lottery and managing the performance of the current licensee during the transition period. In addition to business-as-usual compliance and vetting activity, the team will react to incidents and manage significant investment proposals from the operator of the third licence.

- 5.7 Our management and oversight of the transition arrangements is agnostic to the identity of the operator.

6 What will the outcome of the fourth National Lottery licence competition mean for the UK's wider lottery market?

UK lottery market overview

- 6.1 Throughout the period of the third National Lottery licence, there have been significant changes in the way consumers purchase products. In retail, for example, distribution has expanded to include petrol station forecourts, a wider range of supermarkets, and self-checkout terminals within retail stores. Online, new platforms, including mobile, have revolutionised the way players interact with the National Lottery.
- 6.2 In addition to technological changes, the relative proportion and total sales revenue of instant win games, especially scratchcards, has increased during this period.
- 6.3 The lotteries market continues to evolve at pace, with more diverse channels and products being introduced worldwide. The policy underpinning the fourth licence seeks to build on third licence principles, while moving to a more outcomes-focused approach.

Society lotteries market

- 6.4 Society lotteries play a vital role in helping charities and other societies to run lotteries for good causes. In 2020, following our evidence-based advice on the relationship between society lotteries and the National Lottery, the government decided to increase the annual proceeds limit for society lotteries to allow them to benefit from greater flexibility to raise more funds for good causes. Since then, we have continued to work with government to ensure the effective delivery of their reforms to society lotteries.
- 6.5 Our advice to DCMS in 2017, and more recently in 2021, was that changes to sales limits are likely to have minimal impact on the National Lottery. The reforms are designed to allow society lotteries to raise more money for the good causes they support, and take careful account of the relationship between society lotteries and the National Lottery, to ensure that both sectors can thrive. There are distinct differences between society lotteries, which offer smaller prizes and less frequent draws, and the National Lottery which is characterised by its larger prizes.
- 6.6 Our research has shown that in the last year, National Lottery sales appear to be stable, and half-year data indicates there may be a slight increase. It also shows that the market share remains consistent with previous years, with the National Lottery continuing to account for just over 90% of lottery market sales.
- 6.7 The Covid-19 pandemic has affected some society lotteries' ability to grow, and it is therefore too soon to see what the real impact of the 2020 proceeds and prizes increases have been.
- 6.8 We have committed to monitoring the impacts of the changes on both lottery markets, to ensure society lotteries are allowed to grow and increase their returns to good causes without detriment to the National Lottery. We have been monitoring participation in both since 2020, before the new limits came into effect.

Annex A – Fourth licence development

The Fourth Licence has been developed to align with our approach to being an evidence led, risk based and outcomes-focused regulator



The **Fourth National Lottery Licence** has been developed in line with the following principles:

- Supporting **innovation** in the operation of the NL, including game design
- **Less prescription**, where appropriate, with a focus on achieving overarching outcomes and allowing for **future proofing**
- **Placing more responsibility on the Licensee**, where appropriate, to ensure outcomes are achieved
- Aligning incentives between the Licensee's **profitability and Good Causes**
- Supporting a more **streamlined and agile approach** to Section 6 Game Licensing
- Anchored by the **Commission's Statutory Duties** with respect to Participant Protection, Propriety and Good Causes

The 4NL Licence Policy has been developed to support these principles.

Evolution area	Description
Incentive Mechanism	New structure that incentivises the operator by more closely aligning profit with returns to good causes
Participant protection	Outcome-based obligation with operator providing assurance statements
Monitoring Performance	Regulatory Model is more outcome-focused, risk based, and evidence led
Channels	Outcome-based obligation to ensure easy access to National Lottery games
Length of Licence	Fixed 10-year period without scope for requests for extension by the operator, with up to 2-year extension period
Branding	Opportunity for creative use of the brand so long as this remains consistent with the statutory duties
Portfolio	Game licences (granted under s6 of the Act) require compliance with the s5 Licence. An outcome-focused and streamlined game approval process will apply.

Annex B – Commercial objectives

The following commercial objectives were, and remain, driven by programme objectives, the statutory duties and the DCMS Single Departmental Plan. The Commission's objective for the competition was to run a process to award a fourth National Lottery licence that:

1. Is fair and transparent throughout
2. Allows for genuine competition between applicants
3. Provides applicants the opportunity to propose innovative solutions, whilst ensuring that the Commission's statutory duties are met
4. Delivers significant social value through the National Lottery, in terms of returns to good causes, as well as wider social benefit
5. Successfully appoints the applicant which proposes the highest credible and deliverable good causes contribution for the fourth licence, whilst ensuring support for the Commission's statutory duties
6. Award the new licence by [April 2022]