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Committee of Public Accounts

The future of the National Lottery

Thirty-First Report of Session 2017–19

Report, together with formal minutes relating to the report

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The Committee of Public Accounts

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Summary

Since 2012, Camelot has made profits well in excess of what was envisaged in the original 2009 licence, whilst returns for good causes have dropped, by 15% in 2016–17 compared to the previous year. The Gambling Commission did not include a reopener or break clause in the 14-year contract. This means that the terms of the contract can only be changed with Camelot's agreement. Camelot's profits were 122% higher in 2016–17 than in 2009–10. The drop in returns for good causes was because more players bought scratch cards, whilst sales of draw based games, with higher returns to good causes, declined. In the context of falling income for good causes, the Department needs to be wary of the risk that Lottery funding programmes become unaffordable. It also needs to give lottery distributors better data on lottery sales so that the distributors are better placed to plan their grant programmes. The Department, Camelot and the Lottery distributors all need to work together to better publicise the benefits to good causes as part of efforts to reverse the recent decline in sales.

Introduction

The Department for Digital, Culture, Media & Sport (the Department) launched the National Lottery (the Lottery) in November 1994. The Lottery, currently run by Camelot UK Lotteries Ltd (Camelot), aims to raise money for good causes in the arts, sports, heritage, health, education, environment and charitable sectors. Lottery products include scratch cards and instant-win games, and draw-based games. A proportion of proceeds from the Lottery is paid into the National Lottery Distribution Fund. This money is drawn on by 12 non-departmental public bodies (the Distributors) that make payments to good causes. The Gambling Commission (the Commission) regulates the Lottery and enforces the terms of Camelot's operating licence. Since it began the Lottery has raised over £37 billion for good causes. After rising for several years, in 2016–17 income for good causes fell by 15% and ticket sales fell by 9%.

Conclusions and recommendations

1. **Good causes lost out when the Gambling Commission renegotiated the licence with Camelot in March 2012.** Following the renegotiation in 2012 of its licence to operate the Lottery, Camelot's profit has increased to 1.0% of sales after tax, rather than the 0.6% anticipated by the Commission in the original 2009 licence. Returns for good causes, per pound spent, have fallen from 27p in 2009–10 to 22p in 2016–17. The licence is supposed to incentivise Camelot to maximise returns to good causes. But returns for good causes were only 2% higher in 2016–17 than in 2009–10, whereas Camelot's profits were 122% higher. The Commission now acknowledges that the renegotiation in 2012 was too favourable to Camelot. Camelot is proposing game changes intended to reverse the decline in revenue and return more to good causes. Any changes will require the agreement of the Gambling Commission.

   Recommendation: ***The Gambling Commission should take steps to secure a fair return for good causes from game changes proposed by Camelot over the remaining life of the current licence.***

2. **The current operating licence is not flexible enough to protect the interests of good causes as player behaviour changes.** Scratch-cards and instant-win games have become more popular, while sales of draw-based games have declined. However, returns for good causes are much lower for scratch cards (on average 10p in the pound) than they are for draw-based games (on average 30p), and so good causes have suffered. The extended licence runs for 14 years with no facility for the regulator to change its terms, other than through agreement with Camelot. This type of contract is is not seen in other regulated sectors where contracts include reopeners or break clauses to reflect changes to the environment. The Gambling Commission acknowledges that it is not comfortable with Camelot's profit growth in recent years compared to the returns to good causes. Camelot is a monopoly supplier and it not clear whether the rate of return it receives is fair and comparable to companies in other regulated sectors.

   Recommendation: ***In setting the next licence, the Gambling Commission needs to benchmark the Lottery against other regulated sectors to determine what a fair rate of return is for operating the Lottery and build flexibility into the licence terms to secure this fair return in changing circumstances.***

3. **Game changes agreed between Camelot and the Gambling Commission have ultimately failed to influence player behaviour as intended, resulting in reduced participation.** In October 2015 the number of Lotto balls in the draw was increased from 49 to 59 and a jackpot cap of £50 million introduced. In January 2016, the jackpot cap was increased to £55 million but then in August 2016 it was reduced to £22 million. Although the likelihood of winning the jackpot was reduced by having more balls in the draw, the increased size of jackpots had been supposed to attract more players, and thus also increase returns to good causes. However, after a short-term boost, the longer term result has been falling sales, and a corresponding decline in returns to good causes In 2016–17 income for good causes fell by 15% compared to the previous year. The Department and Camelot acknowledge that

the game changes in 2015 and 2016 have contributed to the fall in income for good causes. Camelot and the Gambling Commission have not been willing to reverse unpopular decisions such as increasing the number of Lotto balls.

Recommendation: ***The Gambling Commission should fully evaluate whether significant game changes proposed by Camelot are supported by appropriate, robust research and should intervene promptly to reverse changes if they prove unsuccessful.***

4. **The Department is not doing enough to test the affordability of the Lottery distributors' forward funding programmes in the context of falling Lottery sales.** The Lottery distributors make commitments to good causes well into the future, and so their commitments will often exceed the funds available to them from the National Lottery Distribution Fund (the NLDF) at a given date. However, in recent years commitments to good causes have been growing faster than NLDF balances. In March 2016–17 the £3 billion NLDF balance was only enough to cover half of the commitments made to good causes; in March 2004 it had been enough to cover 96% of the commitments. In 2016–17 three of the six largest distributors increased their grant commitments at the same time as Lottery income fell. The affordability of the Lottery funding programmes is currently a high risk on the Department's strategic risk register and the situation could worsen if Lottery revenue continues to decline.

   Recommendation: ***The Department should test the distributors' modelling of future grant programmes and intervene where it believes forward programmes may be unaffordable.***

5. **The Department is not giving the Lottery distributors the information they need to manage their forward programmes.** The Lottery distributors require information on expected future lottery income in order to plan the grants they will make to good causes and assess the affordability of the current programmes to which they are committed. The Department has real-time information on weekly sales, which the distributors have requested, but the Department has withheld it, believing that the volatility of sales from week to week makes the data open to mistinterpretation by the distributors. The Gambling Commission has started to produce more sophisticated forecasts of future income from Lottery sales for the good causes. But the forecasts do not yet take into account the impact of planned structural changes to the Lottery coming out of Camelot's Strategic Review and so the distributors do not yet have a forecast which reflects the Department's expectations for the future performance of the lottery.

   Recommendation: ***Starting immediately, the Department should share real-time weekly sales data with the distributors. The Department or Commission should ensure that the distributors have any help they need to understand and interpret the data and, during 2018, provide an updated forecast to distributors taking into account Camelot's plans to address the decline in lottery sales.***

6. **We are concerned that awareness of the National Lottery's support for good causes has fallen, and that this is likely to have contributed to reduced participation.** The huge contribution made to good causes is less evident to the Lottery player than it used to be. National Lottery draws are no longer broadcast by the BBC and good

causes are not mentioned on lottery tickets or well-advertised at the point of sale, either online or in shops. This means that players are less aware of the link between playing the lottery and supporting good causes. They are less positive about the Lottery and so buying fewer tickets. The Department and Camelot agree that good causes should be promoted more in Lottery advertising and Camelot acknowledges that it should do more to promote good causes and the contribution that the Lottery makes to local communities.

Recommendation: ***Camelot should work with the Lottery Distributors to better publicise the link between good causes and the Lottery and communicate the contribution to good causes from each type of game to customers at the point of sale. We would expect improvements to have been implemented by September 2018.***

7. **We are not convinced that Camelot is doing all it can to support education and research for gambling awareness.** Camelot believes that the majority of Lottery players do not see themselves as gamblers. Nevertheless, Lottery products, which offer the chance to win big sums for a relatively small stake, are easily accessible to 16 and 17 year olds, and there is a risk that they could be the start of gambling problems. Given the popularity of the Lottery it is also clearly the case that there will be many people with gambling problems who are also Lottery players. Prior to our evidence session Camelot agreed to increase its contribution to GambleAware from £190,000 to £300,000, and claimed that GambleAware were "broadly" content with that amount. However, GambleAware, which aims to prevent people from getting into problem gambling, and to support those who do, has stated that the amount falls well short of expectations that had been made clear to Camelot.

Recommendation: ***Camelot should review its level of contribution to deal with problem gambling and explain to us within six months why this is a fair contribution to GambleAware for such a widely-played gambling product.***

1 Oversight of Camelot as the National Lottery operator

1. On the basis of a report by the Comptroller and Auditor General, we took evidence from the Department for Digital, Culture, Media and Sport (the Department), the Gambling Commission (the Commission), the Big Lottery Fund and Camelot UK Lotteries Ltd (Camelot) about National Lottery funding for good causes.[1]

2. The Department for Digital, Culture, Media and Sport (the Department) launched the National Lottery (the Lottery) in November 1994. The Lottery's overarching objective is to maximise returns for good causes through selling Lottery products in an efficient and socially responsible way. Camelot UK Lotteries Ltd (Camelot) has operated the Lottery since its launch; its third licence to do so came into force on 1 February 2009. The Gambling Commission (the Commission) regulates the Lottery and enforces the terms of Camelot's operating licence.[2]

3. There are two main types of Lottery game: draw-based games, and non-draw based games called 'instants' (scratch cards and interactive instant-win games). On average, for every £1 of ticket sales, 25p goes to good causes, 53p to prizes, 12p to Lottery duty, 4p to Lottery retailers, and 5p to Camelot (of which approximately 4p covers costs and 1p is profit). The money for good causes is paid into the National Lottery Distribution Fund, which is maintained under the control and management of the Secretary of State for Digital, Culture, Media & Sport. This money is drawn on by 12 non-departmental public bodies (the Distributors) that make payments to good causes. Since it began the Lottery has raised over £37 billion for good causes and reports that it has funded more than 525,000 projects in the arts, sports, heritage, health, education, environment and charitable sectors.[3]

4. Lottery sales and income for good causes increased from 2004–05 to 2015–16, but fell in 2016–17. In the 12 months to March 2017, income for good causes fell by 15% to £1.63 billion at the same time as Lottery sales fell by 9% to £6.93 billion. Camelot has predicted a further fall in ticket sales and income for good causes in 2017–18.[4]

Licence renegotiation

5. The third licence to run the Lottery came into force in February 2009. Between 2009–10 and 2016–17, Camelot's profits increased by 122% (£39 million) to £71 million. Comparing the same dates, returns for good causes increased by only 2% (£31 million) to £1.5 billion.[5] We asked Camelot whether this difference was justifiable and it referred to the firm's additonal £181 million of capital investment over this period and the benefits it had secured from favourable changes in corporation tax rates.[6]

1 Report by the Comptroller and Auditor General, Investigation: National Lottery funding for good causes, Session 2017–19, HC 631, 13 December 2017

2 C&AG's Report, paras 1.1–1.4

3 C&AG's Report, paras 1, 1.1, 1.4

4 Q 1; C&AG's Report, para. 2.7, Figure 8

5 Q 76; C&AG's Report, para 2.4, Figure 6

6 Q 76

6. In March 2012, the Commission renegotiated the licence with Camelot. This extended the licence by four years to 2023 and enabled Camelot to retain more (70% compared to the previous 20%) of any costs savings it generates under a mechanism within the licence to share profits with good causes. In exchange, Camelot agreed to invest in the roll-out of 8,000 new Lottery sales terminals.[7] The Gambling Commission told us that it felt that overall the third licence period has been a success, with contributions to good causes on average 30% higher each year than under the previous licence.[8] However, returns for good causes, per pound spent, have fallen from 27p in 2009–10 to 22p in 2016–17.[9]

7. We asked whether the Commission was comfortable with Camelot's growth in profits since the renegotiation of the licence. The Commission said that it was difficult to be comfortable given the trends in Lottery sales and returns to good causes. The Commission noted that Camelot's profit at present sat at 1.0% of sales after tax, rather than the 0.6% that had been anticipated by the Gambling Commission in granting the licence in 2009.[10] The Commission also acknowledged that, with hindsight, the renegotiation of the cost-sharing arrangement in 2012 had been too favourable to Camelot and that this had been the main driver for its profits growth since.[11]

8. The Commission told us that that to negotiate the existing licence now would distract Camelot and discourage future competitors.[12] Wherever possible within the framework in the existing licence, it was looking to renegotiate with Camelot to secure a more equitable share of sales for good causes, relative to that retained for prizes and to cover Camelot's costs and profits, particularly for new game proposals.[13]

Inflexibility in the operating licence

9. The method of calculating returns for good causes was set in the third licence in 2009 and does not reflect subsequent changes in the sales across different types of Lottery games. Although the method is intended to incentivise Camelot to maximise returns to good causes, the amount that Camelot retains is a percentage of ticket sales, rather than being linked directly to funds raised for good causes[14].

10. Since the third licence was awarded, the Department and Camelot told us that there was a global trend in which players have moved away from draw-based games towards products with faster and higher prize payouts.[15] This has made maintaining the sales of draw-based games more challenging and the proportion of lottery sales accounted for by draw-based games has decreased from 76% in 2009–10 to 58% in 2016–17.[16] Despite this, the Department told us that it did not think that scratchcard sales were replacing sales of draw-based games.[17]

7 Q 16; C&AG's Report, Figure 1, paras 1.2, 2.6
8 Q 17
9 C&AG's Report, Figure 10
10 Q 75
11 Q 84
12 Q 21
13 Q 21
14 C&AG's Report, paras 2.3, 2.10
15 Qq 4, 23
16 C&AG's Report, Figure 7
17 Q 4

11. Average returns for good causes are much lower for scratch cards (10p in the pound) than they are for draw-based games (30p), and so good causes have suffered from the recent changes in the sales mix.[18] We asked Camelot whether it was incentivised to promote certain types of game, as it retains 3% from additional net sales of draw-based games but 7% from additional net sales of scratchcards.[19] Camelot denied that this was the case and told us that it was incentivised to maximise the net proceeds of the lottery and was spending all of its advertising money on lottery Euromillions, because it drove the greatest returns for good causes.[20]

12. The Commission has no means of amending the licence to reflect market developments other than through agreement with Camelot. The Commission told us that the next licence competition should query whether a 14-year licence period was right.[21] This length of contract is not seen in other regulated sectors where contracts include reopeners or break clauses to give flexibility when circumstances change. The Commission also suggested that it would be useful to assess what a reasonable rate of return should be for a Lottery operator to receive compared to companies managing public assets in other regulated sectors.[22]

The effect of game changes

13. For each major Lottery game change, Camelot submits a business case to the Gambling Commission for approval. In October 2015, in agreement with the Gambling Commission, Camelot increased the number of Lotto balls in the draw from 49 to 59 and introduced a jackpot cap of £50 million. The jackpot cap was raised to £55 millon in January 2016, but reduced to £22 million in August 2016 following a drop in sales.[23]

14. We asked Camelot whether these contradictory game changes had contributed to people spending less on the Lotto game. Camelot accepted that, after a short-term boost to sales, these game changes had contributed heavily to a disappointing year in 2016–17. Unpopular decisions such as increasing the number of Lotto balls, have not been reversed. Camelot's research indicates that current Lotto players do not want any further disruption to the game.[24]

15. Prompted by the recent downturn in sales, Camelot completed a strategic review of its lottery business in November 2017. Camelot told us that, based on its findings, it is proposing changes intended to reverse the decline in revenue and return more to good causes, for example via a new annuity game. Camelot told us that it is looking to grow sales by about £400 million over next two years, and that it will generate between £60 million and £80 million extra for good causes.[25]

18 C&AG's Report, Figure 9
19 Q 33; C&AG's Report, 2.10
20 Q 34
21 Q 22
22 Q 75
23 Qq 72–74; C&AG's Report, paras. 2.11–2.12
24 Q 72
25 Qq 30–32

2 Managing future funding programmes for good causes

Assessments of affordability

16. The twelve National Lottery distributors award grants to good causes in line with policy directions set by the Department for Digital, Culture, Media and Sport (the Department) or devolved adminstrations, as appropriate. Lottery income builds up in the National Lottery Distribution Fund (the Fund) until it is paid out by the distributors. Since distributors have no control over Lottery income, they manage their balances by planning future grant awards based on available information from the Department on future Lottery income.[26] Distributors often have commitments spanning many years so it is likely that commitments will exceed their Fund balances at a given date. However, from 2009–10 to 2016–17, the total available Fund balance increased by 18% to £1.54 billion, while total grant liabilities increased by 37% to £3.04 billion. The Fund balance at 31 March 2017 was therefore enough to cover 51% of funding commitments. In March 2004 the Fund Balance had been enough to cover 96% of distributors' funding commitments.[27]

17. At 31 March 2017 three of the six largest distributors had greater liabilities than they had had at 31 March 2016. During 2016–17 Sport England increased its liabilities by £4 million to £260 million (from 208% of its available Fund balance to 268%), the Big Lottery Fund increased by £112 million to £1,366 million (from 303% to 342%), and the Heritage Lottery Fund by £27 million to £1,023 million (from 167% to 206%).[28]

18. We asked the Big Lottery Fund why it had been appropriate to increase its commitments at a time of falling Lottery income. The Big Lottery Fund explained that its strategic programmes extend over a long-term period, typically around seven years, so it needs to take a long-term perspective and aims to smooth the flow of funds as far as possible. It said that it wanted to see what happened to Lottery income over the next two years before making a decision about how that might affect its strategic programmes.[29] It claimed that its planning of commitments against its income over a seven-year period was such that it was not vulnerable, should Camelot's forecasts of extra income over the next 2 years prove not to be correct. The Big Lottery Fund said that in 2016–17 it had still been operating on a forecast Fund income of £1.8 billion, that it had to careful about making choices too quickly because it was not clear whether falling income was yet a trend, that it had then reduced the money it planned to pay out by "a little bit", and was still confident it could meet all its commitments.[30]

19. The gap between distributors' grant liabilities and the Fund balance grew to £1.5 billion at March 2017, £369 million higher than a year earlier. For one distributor, its cash flow forecast showed its Fund balance falling to nil in 2020 if its current award programme remained unchanged and recent trends in Lottery income continued.[31] The Department told us that it was very alive to sustainability concerns. It stressed the

26 C&AG's Report, Figure 3, para. 3.2
27 C&AG's Report, paras 6, 7, Figure 12, para. 3.4
28 C&AG's Report, Figure 13, para. 3.6
29 Q 58
30 Qq 57–59
31 Q 61, C&AG's Report, Figure 12, para 3.17

experience of distributors in "managing stocks and flows", commented that "everyone is now being more cautious looking forward" and also that "we are all concerned about the long-term impact if there is a sustained decrease [in income from the Lottery]". The Department stressed the serious impact if some projects, such as heritage capital projects that require multi-year funding, could not be finished and said the issue was high up in its risk register.[32]

20. The Department has underwritten the costs of UK Sport's Lottery funded programmes up to the Tokyo Olympics in 2020. The Department explained that UK Sport, when making its decisions about the 2020 Olympics, had reasonably assumed that Lottery income would be higher. Once it became clear that was not the case the Department had decided to underwrite the costs rather than run the risk of potentially damaging medal hopes. It told us that it would finance its guarantee to UK Sport as far as it could from underspends in other programmes. It said that UK Sport was unique and it did not expect to have to do the same for other distributors.[33]

Information on Lottery income

21. The Lottery distributors would like to receive prompt data on weekly sales to allow them to spot declining or increasing income early, to help them plan their future grant awards. The Department receives real-time information on weekly sales from Camelot which the distributors have requested.[34] The Department told us that the distributors do receive weekly sales data from Camelot, but three months in arrears. It said that sharing real-time weekly data with the distributors "would not be helpful". On the one hand, the Department had argued that the distributors were very capable and sophisticated when it came to managing commitments against future income. On the other hand the Department seemed to be arguing that the same distributors would not be able to handle real-time weekly information on sales because the volatility of sales from week to week might be misinterpreted by them.[35]

22. We challenged the Commission on why it had taken over 10 years to act on a previous recommendation from the Committee for more sophisticated modelling of future income for good causes.[36] In the past the Department provided fairly basic information to the distributors, which projected future income based purely on projecting historical trends into the future. Since June 2016, it has started to provide them with more sophisticated information, but the distributors have raised concerns that the modelling still makes no adjustment for the impact of any structural changes in the Lottery, such as game changes to address the recent fall in sales.[37]

23. The Commission told us that it is working on a more sophisticated model to forecast future income levels based on experience of how the Lottery products are working and allowing for factors such as competition and dynamics in the market. It said it had "run that model out for the first time" and a fresh version would be available by the end of March 2018. The Commission also told us that it would be injecting into that model some

32 Q 60
33 Q 28
34 C&AG's Report, para 9
35 Qq 61–63
36 Q 65; Committee of Public Accounts, First Report of Session 2005–06, Managing National Lottery Distribution Fund balances, HC 408, 18 October 2005
37 C&AG's Report, para 8

of the projections from Camelot's strategic review, and that it would be improved on over time. It acknowledged that it needed to put its efforts into making the model work effectively for everyone in the future, and commented that the model would be "a much more stable and sophisticated basis for forward funding".[38] The Department also pointed to the new forecasting model meaning that distributors get better information than in the past, while acknowledging the need for the model to take account of changes that Camelot would be bringing in.[39]

38 Qq 64–65
39 Q 61

3 The impact of the National Lottery on society

Marketing the link to good causes

24. The Department for Digital, Culture, Media and Sport (the Department) and Camelot UK Lotteries Ltd (Camelot) are keen to improve the marketing links between the National Lottery (the Lottery) and good causes it supports though grant awards from Lottery distributors, particularly since the fall in Lottery sales.[40] The Department told us it had been looking at whether there is declining positivity towards Camelot and the Lottery in general and acknowledged that "there has perhaps not been the best marketing recently of the impact on good causes."[41] The Department also said it was working with distributors on having a more unified brand and increasing visibility and said it had produced a "digital toolkit" to promote more the positive outcomes from funding good casues.[42]

25. Camelot told us that its strategic review had identified "three or four key pillars" on which to grow Lottery sales and agreed with the Department that it needed to bring the fact that money goes to good causes further to the front of the brand. Camelot said it had an ambition to get back on national television, having not been on the BBC since 2015.[43] We asked Camelot whether more could be done at constituency level to promote good causes, and whether people were made aware when buying tickets that local projects had been financed by lottery money. Camelot told us that it did some work of this sort, but acknowledged that it did not do enough. It said that, working with the distributors, it wanted to amplify the good cause message, and make it local to communities, so that people understood buying a ticket could help local projects.[44]

Responsible gambling

26. Lottery products, which offer the chance to win big sums for a relatively small stake, are easily accessible to 16 and 17 year olds, and there is a risk that they could be the start of gambling problems. The Department told us that it had not, to date, seen participation by 16 and 17 year olds in a lottery as particularly worrying, but acknowledged lobbying from bodies such as GambleAware that even participation in a lottery rather than other forms of gambling could engender bad habits. The Department said that the issue was "certainly something we are interested in and looking at."[45]

27. The Gambling Commission requires that all licensed gambling businesses, including Camelot and society lotteries, make a financial contribution towards research, education and treatment of problem gamblers. The Commission does not currently specify the amount which licensed bodies contribute and so the value of the annual contribution is voluntary.[46] Camelot told us that the majority of Lottery players do not see themselves

40 C&AG's Report, para 2.15
41 Q 3; C&AG's Report, 2.15
42 Q 13
43 Q 30
44 Q 47
45 Q 5
46 http://www.gamblingcommission.gov.uk/for-gambling-businesses/Compliance/General-compliance/Social-responsibility/Research-education-and-treatment-contributions.aspx

as gamblers, and that Lottery advertisements do not include the GambleAware signs or links to support services for people with gambling problems.[47] Nevertheless Camelot acknowledged that it is appropriate for it to make a financial contribution, albeit that an appropriate amount would be calculated on a different basis to other gambling companies.[48]

28. Prior to our evidence session Camelot agreed to increase its contribution to GambleAware from £190,000 to £300,000. Camelot stressed that the increase had been purely voluntary, and had been agreed following constructive discussion with GambleAware before Christmas, and claimed that the increased amount was "broadly" what GambleAware had been looking for.[49] However, GambleAware wrote to us after the evidence session and said that it was not happy with the £300,000 contribution. It stated that it had asked Camelot for over £700,000, which it considered to be a more appropriate amount, and that it had made that position clear to Camelot. GambleAware claimed that Camelot had agreed to give careful thought to adding a further £400,000 to bridge the gap between Camelot's donation and GambleAware's expectations.[50]

47 Q 12
48 Q 7
49 Qq 6, 8–11
50 GambleAware (NLF0005)

Formal minutes

Monday 26 March 2018

Members present:

Meg Hillier, in the Chair

Bim Afolami	Anne Marie Morris
Gillian Keegan	Lee Rowley
Shabana Mahmood	Gareth Snell

Draft Report (*The future of the National Lottery*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 28 read and agreed to.

Introduction agreed to.

Conclusions and recommendations agreed to.

Summary agreed to.

Resolved, That the Report be the Thirty-first of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Wednesday 26 March 2018 at 2.30pm

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the inquiry publications page of the Committee's website.

Wednesday 24 January 2018

Question number

Sue Owen, Permanent Secretary, Department for Digital, Culture, Media and Sport, **Sarah Harrison**, Chief Executive, Gambling Commission, **Nigel Railton**, Chief Executive UK, Camelot, and **Dawn Austwick OBE**, Chief Executive, Big Lottery Fund — Q1–85

Published written evidence

The following written evidence was received and can be viewed on the inquiry publications page of the Committee's website.

NLF numbers are generated by the evidence processing system and so may not be complete.

1 Big Lottery Fund (NLF0004)

2 Camelot (NLF0006)

3 GambleAware (NLF0003)

4 GambleAware (NLF0005)

5 Lotteries Council (NLF0007)

6 Sport and Recreation Alliance (NLF0002)

7 The Lotteries Council (NLF0001)

List of Reports from the Committee during the current session

All publications from the Committee are available on the publications page of the Committee's website. The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2017–19

First Report	Tackling online VAT fraud and error	HC 312 (Cm 9549)
Second Report	Brexit and the future of Customs	HC 401 (Cm 9565)
Third Report	Hinkley Point C	HC 393 (Cm 9565)
Fourth Report	Clinical correspondence handling at NHS Shared Business Services	HC 396 (Cm 9575)
Fifth Report	Managing the costs of clinical negligence in hospital trusts	HC 397 (Cm 9575)
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HOUSE OF COMMONS

Public Accounts Committee

Oral evidence: Decline in National Lottery income, HC 631

Wednesday 24 January 2018

Ordered by the House of Commons to be published on 24 January 2018.

Watch the meeting

Members present: Sir Geoffrey Clifton-Brown (Chair); Chris Evans; Caroline Flint; Luke Graham; Nigel Mills, Stephen Morgan.

Sir Amyas Morse, Comptroller and Auditor General, Adrian Jenner, Director of Parliamentary Relations, National Audit Office, Paul Keane, Director, NAO, and Marius Gallaher, Alternate Treasury Officer of Accounts, HM Treasury, were in attendance.

Questions 1-85

Witnesses

I: Sue Owen, Permanent Secretary, Department for Digital, Culture, Media and Sport, Sarah Harrison, Chief Executive, Gambling Commission, Nigel Railton, Chief Executive UK, Camelot, and Dawn Austwick OBE, Chief Executive, Big Lottery Fund.

Examination of witnesses

Witnesses: Sue Owen, Sarah Harrison, Nigel Railton and Dawn Austwick.

Q1 **Chair:** Good afternoon everybody. Today we are investigating national lottery funding for good causes. The sum raised for good causes from the national lottery in 2016-17, which amounts to £1.63 billion, was 15% lower than in the previous year. DCMS has not been able to determine the exact causes, which complicates its efforts to address the drop. Increases in Camelot's profits for operating the lottery have outstripped increases in income for good causes. Profits have increased particularly rapidly since the March 2012 licence renegotiation, which suggests that Camelot secured too good a deal at that time.

Funding commitments made by the distribution of lottery funds as at 31 March 2017 were £3 billion, almost double the available cash before that date, posing questions about the affordability of the forward programme for good causes. This afternoon, we want to get some answers from DCMS, the Gambling Commission, Camelot and the Big Lottery Fund on the extent to which the recent fall in lottery income in the year 2016-17 was part of a long-term trend and what they are doing to arrest that; whether the current regime for the oversight of Camelot is adequate; whether the current lottery operating licence is fit for purpose; what the fall in income means for good causes funded by the lottery; and what distributors are doing to ensure that the future funding programmes are affordable.

With those opening remarks, I extend a warm welcome to our witnesses, who today, from my left to right, are Dawn Austwick, the chief executive of the Big Lottery Fund; Sarah Harrison, the chief executive of the Gambling Commission; Sue Owen, the Permanent Secretary of the Department for Digital, Culture, Media and Sport; and, finally, but no wise least, Nigel Railton, the chief executive of Camelot UK Lotteries Ltd. Welcome to all of you.

Ms Owen, may I start with you on an issue that is unrelated but nevertheless extremely topical? Can you give us an update on the Carillion issue as it may be attributed to your Department, and tell us what if any contracts your Department has with Carillion and what you are doing to secure the continuity of the services that Carillion formerly provided?

Sue Owen: Understandably, this is a troubling time for many. The direct impact on DCMS and its arm's length bodies is limited to a contract that Carillion has with the British Museum to provide facilities management services. We had contingency plans in place. We had discussed them with the British Museum beforehand. They worked well. Services have continued to be provided during this interim period, while longer-term plans are put in place. We are in touch with the museum and continuing to support them, but to date there has been no discontinuity in service.

Q2 **Chair:** That is very helpful. Perhaps you can just set the scene for us, Ms Owen. I take you to paragraph 2.9 in the NAO Report, which says, "Between 2009-10 and 2016-17, the returns for good causes per pound spent fell from 26.9p to 21.6p." That trend of falling income is not just restricted to the last year, is it? It is part of a longer-term trend.

Sue Owen: This is a very timely inquiry. I completely agree that the result in 2016-17 was disappointing, and the level in this current year is likely to be no better. Of course, 2015-16 was an exceptionally good year, driven by huge roll-overs, and 2016-17 was still the sixth highest level ever. We have to see it in context, but I totally think we all need to work together to pull out all the stops to return the national lottery to growth. There has been a trend decline in sales of the Lotto, and that is something we can explore further today with Camelot and the Gambling Commission.

Chair: We will certainly be doing that. I now hand over to my colleague, Chris Evans.

Q3 **Chris Evans:** Ms Owen, it seems that the national lottery was doing very well between 2005 and 2016; there was an increase of 42% in income for good causes between those years, and suddenly it dropped by 15%. Do you have an explanation of why that happened?

Sue Owen: There are a lot of factors. There have been reforms to the Lotto game itself at several points in the last five or six years. They have all provided a short-term boost, but were not enough to avoid the long-term decline. There has been a change in player behaviour over time, and Nigel will talk a lot more about that. Participation in the main Lotto game itself has been declining significantly. There is increased popularity of scratchcards and instant wins, which need higher prizes and therefore return less to good causes. Those are the two overriding factors.

We have looked a bit ourselves at whether there is also declining positivity towards Camelot and the lottery in general. Anybody who listened to Radio 5 Live this morning, anticipating this hearing, will have heard some of that kind of sentiment, and of course folk like the Health Lottery are critical, too. There has perhaps not been the best marketing recently of the impact on good causes—the benefits. We are all doing something about that. Then there are factors, which we have looked at, to do with the competitive environment that the lottery is acting in. We don't think those have been that significant to date, but we are very alive to the fact that they could become more significant.

Overall, I would look to the change in player behaviour over time as the issue we have to collectively address.

Q4 **Chris Evans:** Just go into what you mean by the behaviour of the player. Is there a typical lottery player?

Sue Owen: Nigel will tell you more about whether there is a typical Lottery player, but we do know that in 2013, 44% of the population participated in the Lotto game sometime during the year. That is down now to 31%. It does look like—this is not just in the UK, but in other countries—you need to attract players through higher prizes. That is what we see with scratchcards and instant win games. Equally, it is important to note that the different bits of the lottery are not competing, we don't think, against each other. Many players do both. Half the Lotto players also play other games and, of the ones who play scratchcards, I think about a third also play the lottery, so we don't think that the different games are cannibalising each other. I think that the trend towards games with higher odds of winning is seen internationally.

See footnote.

Q5 **Chris Evans:** You talk about higher prizes. As you know, the lottery is the only gambling product in this country that you can gamble on at 16. Are you concerned in any way that you are walking a fine line between gambling addiction, which is a real problem, and scratchcards, which are available and whose higher prizes could lead people who are 16 down the path of gambling problems in the future?

Sue Owen: We do talk a lot to our colleagues in the Gambling Commission about problem gambling. We haven't to date seen participation by 16 and 17-year-olds in a lottery as particularly worrying, but I know that bodies like GambleAware are lobbying us to argue that that kind of behaviour starts young and that even participation in a lottery rather than other forms of gambling could engender bad habits, so that is certainly something we are interested in and looking at.

Q6 **Chris Evans:** Mr Railton, how much does Camelot contribute to schemes that eradicate gambling addiction through education and rehabilitation?

Nigel Railton: We met GambleAware before Christmas, and we voluntarily increased our contribution. We were contributing £190,000 a year, and we increased it to £300,000 just before Christmas.

Q7 **Chris Evans:** In comparison with other gambling companies, how high is that?

Nigel Railton: I don't think we can compare ourselves with other gambling companies, to be honest. For most gambling companies, I think the levy that was talked about was based on a percentage of gross gaming yield. I think you will be familiar with the formula that it is sales less prizes. Our formula and the mechanics we work on are very different. Our gross gaming yield would be hundreds and hundreds of millions. It is appropriate that there be a levy, but we need to think about what is the appropriate levy for the national lottery.

Q8 **Chair:** Can I just clarify that, Mr Railton? In the evidence we have had from GambleAware, it says, "However, their donation,"—that is, your donation—"along with many others within the gambling industry, has not met what we regard would be a reasonable minimum contribution to GambleAware to enable it to deliver its responsibilities as identified in the National Responsible Gambling Strategy." Is the increase that you have just announced pre or post this evidence? Would you know that?

Nigel Railton: It is pre. We paid it post, but we agreed it with them pre. I met them before Christmas. I have to say I am slightly disappointed with their submission.

Q9 **Chair:** That they did not allude to that?

Nigel Railton: I met them before Christmas. We had a very constructive conversation. We have offered to provide them with data that we have to help them more broadly, and we voluntarily increased our contribution. We had a very constructive dialogue before Christmas.

Q10 **Chair:** Was the £200,000 contribution that you have now agreed with them what they were looking for?

Nigel Railton: We have increased it from £200,000 to £300,000.

Q11 **Chair:** From £200,000 to £300,000, yes. Was that what they were looking for?

Nigel Railton: Broadly, yes.

Sir Amyas Morse: If I may quickly ask a question on that, we published on 13 December and you must, Mr Railton, have been aware that we were working on the Report a couple of months before that. Is it your evidence that the fact that we were doing this Report had no influence on your increased contribution? Is that what you are saying?

Nigel Railton: Yes. I only saw the submission from GambleAware this week. Maybe that was remiss of me, but I did not see it before this week. We made that purely voluntarily. We had a good conversation with them, they explained what they were trying to achieve and we would like to help and contribute to that.

Chair: Thank you. Let's move on.

Q12 **Chris Evans:** Before I leave that, I have one quick question. Do any of your advertisements carry GambleAware signs or directions to problem gambling helplines?

Nigel Railton: Not currently, but the majority of our players do not see themselves as gamblers. They see themselves as lottery players.

Q13 **Chris Evans:** If I can come back to you, Ms Owen, obviously you are in a competitive environment. We know about that. There is the behaviour of the player, and many of the reforms to the Lotto game, such as moving from 49 balls to 59 balls, give a short-term boost, but obviously not in the long term. How can you turn the fortunes of the lottery around?

Sue Owen: We have been working over at least the last year with all my colleagues around the table on a seven-point plan, the most important of which is Camelot's strategic review. They have been looking at refreshing some of the games, including a new annuity game, some retail outlet changes, some changes to their digital offering and some attempts to try to reconnect the brand with good cause returns more on TV. That is clearly very important. The Gambling Commission has approved some changes that we are bringing in to prohibit betting on EuroMillions, which was exploiting a loophole in the legislation.

The Gambling Commission also, a while ago now, initiated a review of board effectiveness at Camelot and there have been a lot of structural changes there. We are challenging Camelot to do some trials where we can look at whether you can have a lower amount of prizes going with scratchcards and instants, and therefore more to good causes. In DCMS, we are considering what the issues are with society lotteries following the Digital, Culture, Media and Sport Committee report. We are working together with Dawn and the other distributors on having a more unified brand and increasing visibility.

Our folk have helped to produce a kind of digital toolkit where we can promote more what the good outcomes of good cause funding are. Quite significantly, we asked for some more sophisticated economic modelling of what determines lottery sales and good cause outcomes. That has been quite interesting and we are sharing that information with distributors.

Q14 **Chair:** I want to come on to Mr Railton about Camelot's investigation into this, but why did you ask the Gambling Commission to carry out an inquiry that was not to include the structural changes that we have not really got on to yet—things such as changing from Lotto to scratchcards? That was specifically excluded from that inquiry. Surely, without examining those structural changes, your inquiry was inevitably going to be fairly limited, wasn't it?

Nigel Railton: Forgive me—

Chair: That was really a question to Mrs Owen. We are talking about two different inquiries here, aren't we? We are talking about your inquiry—the Camelot inquiry—which I want to ask you about in a minute, Mr Railton, but also the Department asked the Gambling Commission to carry out its own inquiry but excluded these structural changes to which I have just referred. I wonder why you asked the Gambling Commission to carry out an inquiry without including structural changes.

Sue Owen: We did not specify that. That is very much something that the Gambling Commission has expertise on.

Q15 **Chair:** It wasn't you, it was the Gambling Commission. Perhaps I could ask you, Miss Harrison, why you did not look at these structural changes.

Sarah Harrison: There are three things that we have been looking at as a regulator in respect of Camelot and the national lottery over the past two to three years. One is clearly trading and performance in relation to Lotto and associated games. The second is not the subject of this Report but is contextually important. That is the performance of Camelot in relation to controls—in other words, how it operates and manages its product, particularly where that interfaces with the customer. We have observed over the past 18 months to two years some poor practices, where the wrong numbers were posted on websites and an app pointed customers towards thinking they were winning when they were not. There were some real issues there. The third dimension to the things that we have been focusing on is governance, quite properly, because in a way it sits across those other two areas.

The exercise of our powers specifically that you are referring to is where we chose to use our review powers to require Camelot and its board in particular—including a lot of engagement with its owner OTPP—to conduct a board effectiveness review. As well as pressing on trading and controls, which I am sure we will come to later, from our point of view it was important to understand that overall, with the right governance sitting across Camelot as a business, it would be able to improve on both controls and trading. That was why we specifically addressed that. In terms of the incentive framework, I am happy to talk about that now, if that is helpful.

Q16 **Chair:** When you talk about that, could you answer a further supplementary question? In that incentivisation payment to Camelot, is there any incentive for them to reduce either their fixed or variable costs?

Sarah Harrison: Okay, I will try to explain in simple terms broadly how this incentivisation framework works. In simple terms, it does two things. It is designed to incentivise Camelot to grow sales and, by virtue of that, contributions to good causes. There are a number of dimensions to that.

The other aspect is that, to ensure that we keep an eye on Camelot's costs, if costs increase that is for Camelot to wear, but if costs decrease and they become more efficient in the way they conduct their business, there is a separate arrangement that allows for a sharing of those cost savings between good causes and Camelot.

The most significant change to the incentive framework was made when the licence was renegotiated in 2012. The effect of that, in particular, was to change that cost-sharing mechanism. For every pound that Camelot saved, roughly 30p went to good causes, whereas 70p went to Camelot. That was a better deal for Camelot than the cost-sharing arrangement that existed in the period before the licence was renegotiated.

There was a good reason for that. At the time, the regulator—the National Lottery Commission—was responding to a request from Camelot to extend the licence in order to invest in more terminals and infrastructure, and indeed that was done. Correspondingly, there were increases from that investment in sales and, therefore, in contributions to good causes. I think what we saw was a coincidence of the change in that particular part of the mechanism, together with a period when Camelot were renegotiating a number of contracts and were taking costs out of the business. The effect of those two things in many respects explains the profit situation, as your chart 6 in the National Audit Office Report demonstrates. I hope that explains how the efficiency point was dealt with.

See Footnote.

Q17 **Chair:** That is fine. Since you have brought up the subject of the renegotiation of the contract, can we stay with that for a minute? Of course, it was negotiated in rather different circumstances to those of today. I wonder whether, with hindsight, it was slightly too generous in that since 2009-10 the income for good causes has fallen by 15%, whereas Camelot's profits have increased by 122%. Camelot came to you and negotiated a better deal for themselves. If this income for good causes keeps falling, is there now a case for you to go to Camelot to ask for a renegotiation of this deal?

Sarah Harrison: I will make a few points on that. It is important to note that that renegotiation did nonetheless generate additional investment and additional sales and additional contributions to good causes. If you step back and look at the licence overall—incidentally, it is not complete, it still has five years to run—the contributions to good causes on average each year are 30% up under the third licence than they were under the previous licence. Even post-renegotiation they are 32% up on pre-renegotiation, so good causes have benefited.

Right now, we sit in two places. First, in terms of the existing incentive framework, as the Permanent Secretary has set out, we are in a very interesting time in relation to Camelot. In many respects, this inquiry, investigation and hearing are very timely, because now is a really important moment to see a shift in the way in which the lottery is delivered and run and the way in which players can enjoy it.

From our point of view, all our focus and the exercise of all our powers is on ensuring that the national lottery is run well and that Camelot, as the steward, is operating in a way that not only maintains the integrity of the lottery, but critically works to maximise contributions to good causes. We see within the existing licence framework—I can give some examples—some scope to make changes. We are already exploring that.

The second key investment for us is in preparing for the next licence competition. We have already started work on that. We started work a year before we did with the previous licence competition. That is important because we need to look at a number of factors in relation to the way in which this licence operates and the market in which the national lottery itself is operating. Our focus is on the existing licence and investment in the framework for the new.

See Footnote.

Q18 **Chair:** So there are two parts of your work at the moment. You are preparing for the new licence, but having extended it, the new licence will start when?

Sarah Harrison: The new licence needs to be awarded by January 2023.

Q19 **Chair:** Yes, so you are starting to prepare for that, but equally, you are looking at whether there should be any changes in the licence before that. Is that correct?

Sarah Harrison: What we are doing is that changes have already been made in the way in which we operate the existing incentive framework in this licence.

Q20 **Chair:** Those were made in 2012, when the licence was renegotiated.

Sarah Harrison: Exactly right.

Q21 **Chair:** What I am trying to get at is, are you currently looking at approaching Camelot to make further changes to the existing licence?

Sarah Harrison: Wherever possible, within the existing incentive framework in this licence, there are things that we have already done, and that we can yet do. In particular, we can renegotiate where it is appropriate. When Camelot comes forward with new game proposals, particularly where they may be associated with new investment, we can look to see where it is possible to strike a different deal in terms of the share of benefits to Camelot versus good causes. There are some examples of where we have already done that and, where it is appropriate, we will continue to do that.

There are other things we can do in relation to the share of funds to prizes relative to good causes. The Permanent Secretary has referenced some work that is under way at the moment in relation to scratchcards. That may also yield better terms for good causes.

It would be misleading of me to suggest that it is appropriate at this stage to completely turn the existing licence inside out and negotiate afresh, for two reasons: first, because we want the principal focus of Camelot to be on improving its performance in trading and other areas that I referenced; and secondly, because there is an important market that we want to create for new investors coming in, and we do not want to send the wrong signals to that market and competition about how this licence is operated and this asset is run. For those two reasons, at this stage we are not exploring completely redesigning the incentive framework. What we are exploring—and doing—is improving on the way the existing incentive framework works, and where we can negotiate better deals for good causes, we will do so.

Q22 **Chair:** With hindsight, was it wrong to extend the licence by an additional four years?

Sarah Harrison: The work we are doing now and starting in relation to looking at the next licence competition will ask the question about whether a 14-year contract is right. If you look across other regulated sectors, you do not find contract terms of that length. You also find other features such as reopeners or break clauses, particularly to reflect where environments change, where market forces change or where policy shifts. There are lots of things to be drawn on from other regulated sectors.

Q23 **Chair:** Okay. Can we got to some of the findings of Camelot's inquiry and some of the things Ms Owen was talking about, and talk about the trend of what is happening out there? What seems to be happening out there is that the draw-based game, Lotto, is declining, where the profitability is greater, in favour of the instant scratchcards, where the profitability to good causes is less. That does seem to be a long-term trend. I wonder what, between you, you are all doing to address this problem.

Nigel Railton: As the Permanent Secretary said, the two games are distinct. If we sold more draw-based games, we would not necessarily sell fewer scratchcard games and vice versa. Let me talk about the trends that I saw from the strategic review that I conducted last year.

Draw-based games around the world are becoming less popular, because there are infrequent draws and they are struggling to compete with other products. The consequence of that in other markets, as the Permanent Secretary said, is that prize payout is increasing. To put that in perspective, in the UK the prize payout on Lotto is about 47%. Italy is an extreme at about 61% and France is paying around a mid-50s percentage.

The trend internationally is for prize payout to increase. The trend in scratchcards is also for prize payouts to increase. We think the optimal level of prize payout in the UK is probably around 74%, not 68%. Something we mentioned to the NAO as part of its Report, but that it did not want to include, is the impact of the taxation system in the UK and the impact of that on good causes. I am quite happy to explain how I think that is a key feature that needs to be considered for the fourth licence competition, if not before.

Q24 **Chair:** Can you clarify that issue about taxation? There is quite a useful pie chart in figure 9, and perhaps we could go to that while you mention taxation. Are you saying that, compared on an international basis, the amount of taxation the UK raises from the lottery is higher than internationally?

Nigel Railton: The UK is a unique market. I was CEO at Camelot Global for four years, so I have been exposed to multiple international markets, which when I came back to do the strategic review gave me a unique insight. Most lotteries' purpose is to maximise net proceeds to society. In most markets they go either to the Treasury or to good causes. In this market, we divide it between the two.

When we look at some of the National Audit Office numbers, for example, when we talk about good causes increasing by 2% from 2009 to 2016-17, that masks the return to society, in duty and good causes, which actually increased by about 10%. The actual number between those years was about £210 million, but 85% of the increase went to duty not good causes. The problem is that the national lottery is in splendid isolation, taxed on a lottery duty on gross sales, rather than the GPT mechanism that the rest of the industry is on.

We have managed to live with that to now, over 23 years, but as these trends of increased prize payouts have become more prevalent, it becomes a problem for us because we can't increase prize payout without decreasing good causes.

Q25 **Chair:** I understand that. Miss Owen, do you want to comment on that?

Sue Owen: The national lottery pays lottery duty. Other forms of gambling are taxed under a different regime. Obviously, you would not expect me to say very much about tax, because that is for the Treasury, but we will certainly take a hard look along with Camelot at whether there is anything in this argument.

If we were to move to a gross profits tax, the tax comes later in the distribution. At the moment, there are sales and various things come off at the beginning, such as retailers' commission. The lottery duty comes off right at the beginning. If we move to a profits tax, it would come later, after the good cause income—after the prizes. You would have to have a much higher rate to get the same amount of revenue.

We will certainly look at all these arguments, but at the end of the day, it is a decision for the Chancellor.

Chair: It is fair to say that it is not just the gambling duties; it is the VAT on Camelot's profits as well which is being paid to the Treasury, so the Treasury is benefiting by increased amounts.

Q26 **Nigel Mills:** It is fair to say that the taxpayer is a good cause in this situation. The revenue that is raised is used for public services, I assume. It is not a bad thing for the lottery to be paying some tax, is it?

Sue Owen: No, that's right.

Q27 **Nigel Mills:** So it is effectively a balance of whether we want more to go to good causes around the country or more to go to the taxpayer. It is not as if there is any obvious right answer, is there?

Sue Owen: That's right. Another argument that Nigel Railton sometimes makes is that society lotteries are treated as a charity and do not pay any tax at all. But they do give money to good causes as well. We cannot say that one good cause is inherently better than another good cause or that either of those are better than money to the Exchequer.

Q28 **Chair:** It might be an appropriate time to ask you this, Miss Owen. On at least one of the distributors, the sports lottery, the Government—your Department—is obliged to maintain the funding. Do you expect that guarantee to be called on, if the profits from distributors keep falling?

Sue Owen: We are not required to, but we have for UK Sport. All the lottery distributors are different. UK Sport, which is for the funding of elite sports for Olympic athletes and so on, has to make decisions that are very lumpy in four-year intervals. When it was making its decisions about the 2020 Olympics, it had reasonably assumed that lottery income would be higher. Once it became clear that was not the position, we had to present Ministers with a choice about letting that risk continue or potentially damaging our hopes of winning a lot of medals.

So we have underwritten UK Sport's Tokyo Olympics effort. We will finance that as far as we can from underspends in other programmes. For example, in the current year, we have an underspend on our 700 MHz spectrum auction and we will use a bit of that money to underwrite UK Sport. We would not necessarily do this for everyone. That was a special circumstance and we were not required to do it.

Q29 **Chair:** I understand. Are there any other distributors that you are likely to have to top up, or are thinking about topping up?

Sue Owen: Not at the moment. I think UK Sport is unique. Each lottery distributor is different. Dawn will talk to you about how they are doing. For example, the Arts Council's budgets for the next period going forward were not going to be set until December 2017, so they were able to take account of the lower outcome in 2016-2017 before making spending commitments. Interestingly, the Arts Council had also built up some reserves, anticipating a poor outcome in the 2015 spending review, which did not actually materialise; but all our distributing bodies are behaving in a pretty cautious way at the moment, and we are in continual dialogue.

Q30 **Chair:** Thank you. Can I just return, because we have got slightly sidetracked there on taxation, and ask Nigel Railton what more you could have done to grow the sales of draw-based games while there was a rapid increase in the sale of instants?

Nigel Railton: The strategic review that I conducted last year has given us three or four key pillars on how we can grow national lottery sales more generally. The Permanent Secretary has already said that we need to bring further to the front of the brand the dual purpose of the national lottery—the fact that players can win prizes and also that money goes to good causes. We are working very closely now with Dawn and other distributors to bring the one national lottery brand to common branding.

We have an ambition to get back on national TV. We came off the BBC in 2015 and would like to be back on national TV. We find that most national lotteries around the world are on TV, so that is an ambition. I find it interesting, because people tend to polarise towards Lotto, but actually draw-based games are now a portfolio of different draw-based games, and it is a formula that works pretty much around the world, where you have four types of draw-based games that have to be segmented very clearly, with very clear consumer offerings.

We have a big jackpot game—EuroMillions. It is very successful. In the US, the equivalent would be something like Powerball. We have the Lotto game; a US equivalent would be a kind of national in-state Lotto. That is normally your millionaire-maker. There is normally then a kind of mini-Lotto. In the UK that is Thunderball; it is normally daily. Then there is normally a gap for an annuity game. An annuity game brings in a different type of consumer that is looking for financial stability; so we are now planning and actively building these games to rebalance the portfolio during the course of this year and early next year. That will then give us an appropriate draw-based games portfolio to offer to the market.

Q31 **Chair:** So what effect does that have? What is it likely to do to the trend in income for good causes?

Nigel Railton: It is going to increase the good causes.

Q32 **Chair:** Can you give us any indication of what that increase might be?

Nigel Railton: It depends on the prize payout we end up settling on for the annuity game, and where Lotto will need to settle at, quite frankly, but we are looking to grow sales by about £400 million over the next two years, and that should generate something between £60 million and £80 million for good causes.

Q33 **Chair:** That is very helpful. I have just one more question formulated: can I talk about your additional submission, which you have given to the Committee since the NAO did their Report? In the middle of that submission, you argue that you are not incentivised to favour any game; but can I take you to paragraph 2.10 in the NAO Report? It says "Based on the mid-2016-17 sales mix, Camelot retains 3% from additional net sales of draw-based games…and 7% from additional net sales of scratchcards." So surely actually you are incentivised to sell more instant and scratchcard games because you make more out of them than the draw-type game Lotto.

Nigel Railton: No, we don't, because I think if you look at the net sales retention there have to be fixed costs and variable costs that come from that. So our costs on scratchcards are quite high and we don't, certainly, manage the business like that. We look at the blend of how we can maximise sales. We are incentivised to maximise the net proceeds of the lottery. That is how we incentivise.

Q34 **Chair:** Nevertheless, how is your promotional structure, your advertising spend, your promotional spend, based? What is the sort of percentage between instants, scratches and draw-based?

Nigel Railton: I can tell you, again, from my strategic review last year, when I looked at what we were spending our advertising money on, all of our support went on lottery EuroMillions, because it drove the greatest returns to good causes; but it is a portfolio. You have to manage the portfolio, and retailers see that. We used to spend £12 million a year on scratchcards, advertising them not just above the line but also promoting them in-store. We used to have hero games each quarter. It brought up the retail estate. It made the national lottery relevant. We have diverted all the spend that was from scratchcards and games that gave a lower percentage to good causes to Lotto and EuroMillions.

Q35 **Caroline Flint:** Who is playing these games—both the draw and the scratch cards? What do they look like? How far is it the same people doing scratch cards and the draw?

Nigel Railton: Okay, the national lottery is for everybody. We have most of the population playing.

Q36 **Caroline Flint:** Obviously, you sell it to everybody. I am asking you who is playing.

Nigel Railton: Sure. I am saying most people across the demographic play. We have around 12 million people playing lotto weekly, still. About 60% of people play scratch cards and play lotto as well. Some people do play the portfolio. To answer the question in a slightly different way—

Q37 **Caroline Flint:** I think I am asking you about the demographics of the people who play the games. What proportion are from low-income families, and what proportion are from either poor or working-class neighbourhoods? What proportion are university educated, and what proportion are not university educated? What work have you done to understand that?

Nigel Railton: We understand our players very well. I do not have all the data with me, but I am happy to submit it.

Q38 **Caroline Flint:** Just a headline then.

Nigel Railton: It's across the piece. There are not any particular stand-outs, where we say we are represented in a particular area. We under-represent right now in 35 to 44-year-olds. They are the people who dropped out the most in the lotto game. We probably under-represent in CDs in 35 to 44 year olds, married couples. That is where we have lost most players. Other than that, there are not many huge trends, but we are happy to submit all the data to the Committee.

Q39 **Caroline Flint:** Can you not just tell me today who your biggest pool of players are and where they are coming from, in terms of demographic, social economic information?

Nigel Railton: What I am saying is that it is across the board.

Q40 **Caroline Flint:** You are saying there is no significant evidence that proportionately a certain group of people—an age group or social economic background—are playing it more than others.

Nigel Railton: Not significant, no.

Q41 **Caroline Flint:** Is that the same for both scratch cards and the draw?

Nigel Railton: Broadly, yes.

Q42 **Caroline Flint:** What proportion of people do the scratch cards and the draw?

Nigel Railton: About 6 million people play scratch cards on a weekly basis.

Q43 **Caroline Flint:** I'm talking about the same people. Are the same people doing the scratch cards and the draw?

Nigel Railton: Yes.

Q44 **Caroline Flint:** They are.

Nigel Railton: Some people, yes.

Caroline Flint: If I can just pursue this—

Chair: Fairly briefly, because we have an awful lot of ground to cover.

Q45 **Caroline Flint:** My concern here is that in terms of the early answers about increasing the share of money that goes to good causes, it seems from the evidence given so far by yourself and Sue Owen that that relies on increasing the amount of players, or potentially increasing the amount of spend by the existing player group. That worries me, particularly around the issue of 16 and 17-year olds, and those who may not have the means to play these sort of games, given their income. It seems to me that encouraging them to do so is not a very good cause.

Nigel Railton: One way of looking at it is that we have about 12 million people on lotto, for example, who play weekly, and we have about 20 million people who play quarterly. One of our ambitions is to get people playing the game more frequently by offering them games they want to play and experiences on lotto and euro-millions that attract them to the game.

Caroline Flint: Which makes my point.

Chair: Yes, it follows on from that.

Q46 **Luke Graham:** On the question of profiling, you talked about the marketing wanting to represent the prize element, but also the good causes. We have been provided with a breakdown of national lottery funding by constituency. There seems to be a general trend that the cosmopolitan constituencies gain considerably more funding for good causes than rural constituencies. As part of your appeal to try to bring in new players, are you taking any consideration of cosmopolitan versus rural, when the number of constituents in each constituency is equal?

Nigel Railton: As a policy perspective, we do not decide where the money is distributed. What we want to do and are doing is working with Dawn and the distributors to make sure that it is not just the metropolitan view of good causes, but that this is for the nation. One of our ambitions this year is to take the national lottery, if possible, back out to the nation. Those plans are still being developed.

Q47 **Chair:** Do you in any sense in any individual constituencies promote lottery good causes? When people go to buy their tickets, are they aware that this community hall or this sports centre has been funded by the lottery?

Nigel Railton: We do, but we don't do enough of it, quite frankly. We don't do enough of anything. I think Dawn will agree from the conversations we have had that we need to do more. What we want to do is amplify that good cause message, and make it local to communities, so that people understand that if you buy a ticket in a store in Rickmansworth—I live near Rickmansworth—it can contribute to a school just up the road. That is what we will be amplifying.

Q48 **Chair:** But on those constituency figures, which presumably you have seen, is there a structural problem between urban versus rural, or is it just the fact that rural areas do not apply for so many grants and therefore do not get awarded so much money?

Nigel Railton: I think the statistics are that each postcode in the UK on average got 185 grants during the national lottery's tenure. We do not decide where the money goes. We do not offer the grants. What we do is try to maximise the money to good causes.

Q49 **Chair:** Can I address that question to you, Miss Harrison, because it seems to me very important? From those statistics, and I accept that they cover only the constituencies of the members of the Committee, it would appear that there is a structural difference between rural and urban constituencies and the amount of—

Chris Evans: And socioeconomic.

Chair: Yes, and socioeconomic areas as well. Is that something that concerns you?

Sarah Harrison: In terms of where the lottery funding goes and who benefits, I am afraid that that is not something that we have a role in.

Q50 **Chair:** Perhaps I will transfer that question to Miss Owen. Is it something that your Department looks at?

Sue Owen: It is certainly Government policy on, for example, arts and culture, to move away from being disproportionately London-based. We will talk to our lottery distributor bodies about that kind of policy background, but at the end of the day, each distributor will make its own decisions about the merits of different applications, and they operate at arm's length from us. As I say, we will give some direction on policy framework, but at the end of the day, Dawn is the one who is actually making these decisions.

Q51 **Chair:** I was going to come on to Miss Austwick. Perhaps I could ask you that question, because the Big Lottery Fund accounts for 40% of the total. That is correct, isn't it?

Dawn Austwick: Yes, we account for 40% of the spend.

Q52 **Chair:** So are you concerned by the types of issues that I and my colleague have been raising on the difference between urban and rural and socioeconomic groups?

Dawn Austwick: We look very carefully at where our money goes geographically. For example, on our responsive funding in England, we look by local authority area, and we track our spend by our responsive funding, which is the money that we give out to organisations that come to us and say, "Would you fund x, y or z activity?" We track that on a rolling five-year basis. We look at how much money is going in and track that against, for example, deprivation statistics like IMD, and then look at a per capita spend.

It is not by any means, I would say, a mechanistic process, which is why we look at it over a time period. There may be all sorts of reasons why a town, such as Great Yarmouth, struggles to take advantage of our funding. We would therefore respond to that by looking at how we can undertake outreach activity, and how we might help to build the strength of civil society. Great Yarmouth is actually a good example, because we recognise that, and have a five-year programme that we are funding with the local authority and the charities in the town to build up their capability. The aim of that is not just that some money goes out in those five years, but that at the end of that period the charities and community groups are more resilient and able to access funding. We do actually look at that very carefully.

Another example is that in Wales over the last two years we have developed and introduced a programme called "Rural Futures". That was very much looking at the fact that—as I am sure some members of the Committee will be well aware—some parts of Welsh rural communities have suffered quite considerably from disadvantage. That is a programme where we are looking at, I think, five areas, and asking those areas to come up, through community groups, with ways in which they would like to build a stronger social and economic fabric.

Q53 **Chair:** So who sparked that conversation? Was it you sparking it with them, or was it them sparking it with you?

Dawn Austwick: In the instance of "Rural Futures" in Wales, we have a horizon-scanning exercise that we undertake on an annual basis where we look across the whole UK at what we think our trends are, what we are learning and what the issues are. Sometimes we do that across the whole UK; sometimes we do that by country.

Q54 **Chair:** When you say country, you mean region?

Dawn Austwick: In this case, Wales. Our Welsh team were looking at what issues are surfacing in Wales that are significant. They do that through all sorts of mechanisms. They will obviously do that through data. They also went out to all sorts of events, like Eisteddfod, and they did vox pops and got views of people and brought those back. As a result of that, our Welsh committee looked at a number of potential options for where we might prioritise, and this was one of them.

The selection of the five areas then goes through a process of application and selection. What the money is spent on is the result of what the communities and charities in those areas say would make the most difference. We respond to that.

Q55 **Chair:** At the end of the day, you can only consider causes where people come to you and make an application.

Dawn Austwick: Not entirely. Our funding pattern is that we have three funding products—I sometimes describe it as a little like Goldilocks and the three bears. We have little ones, which are the National Lottery awards for all. Three are upwards of 10,000 of those in any one year; they are all for under £10,000, and they go into every constituency across the land.

Then we have middle-sized ones. Those tend to be up to three years of funding for a medium-sized charity, and are probably about £200,000 to £300,000. You are absolutely right: in those instances, those are charities coming to us, and we are looking across at what people bring to us and making a set of judgments.

The third type of funding is what we call partnership funding. There, we are more likely to be looking at the theme I just described with Rural Futures. In our England portfolio, we have five very large strategic programmes running at the moment that in effect cover significant social issues from cradle to grave. One of them is called A Better Start, which is trying to improve the life chances of those born in the most disadvantaged circumstances during the ages of nought to three. That operates across five places in England. In each place, we are working with multiple partnerships that will cross local authority, health service and the charity and community sector.

Q56 **Caroline Flint:** I was interested in which places those five programmes in England are in.

Dawn Austwick: Across all those programmes, I think we are in 68 different places in England. I would be very happy to furnish you with a list of which programme is in which town.

Q57 **Chair:** That is very helpful. Ms Austwick, you know without having heard about the fall in income to good causes. What will that mean for your fund?

Dawn Austwick: We operate a five year-plus budgeting cycle. One of the reasons we do this is because a lot of our funding is very long-term. So, in particular, those strategic programmes I was just talking about will all be seven years or thereabouts. We always want to take a long horizon.

Another reason we like to do that is so that we can smooth the flow of funds, so that we can manage, if you like, any shocks to the system. Looking back historically over the last five or six years, you can see that funding has gone up and down and up and down. The smoothing enables us to plan more effectively. What it means in the short term is that we set a smaller budget for the amount of money that we will commit for the future, but I have to say that in this year and the next financial year, we would expect to be paying out more—money flowing out into communities and charities across the land—than we did last year. That is partly a function of our existing commitments.

Our aim is to smooth as far as possible. Within the context of making grants moving forward, we look at those three products I talked about and we would aim to protect, in the first instance, the very small grants that go out and are really the lifeblood of associational life in this country. Our budget for that is around £80 million to £90 million a year. That tends to be money that is paid out within year—they are one-off grants. All our other grants tend to run over multiple years.

We would then look to ensure that those middle-sized grants were as protected as possible. We are in some ways fortunate, because of the cycle we are in with our strategic partnerships, that we have a significant number of them already in train, so we were not planning to commit to a whole series of new ones. In a sense, we want to see what happens over the next two years before making a decision about that.

Q58 **Chair:** People may have to go, and we have a lot of ground to cover in quite a short space of time, so I appeal for short answers. Let us suppose that Mr Railton's optimistic forecasts of how much extra money he is going to make over the next two years prove not to be correct, and let us suppose there is a long-term trend in the decline of money to give to good causes. If you are arranging your affairs on a seven-year basis, does that not leave you vulnerable?

Dawn Austwick: No, because we look at how much money we have in our LDF balance. We look at what commitments we have over that seven-year period and then we look at what is a likely income stream. In planning our income and our commitments we look at a best case, a central case, a low case and a worst case. In all those instances, we look at how we would move our grant commitments around.

Q59 **Chair:** Basically, was it right in 2016-17 to increase the amount you were paying out, which you have just said, when we know that the amount of money that you were getting is actually falling?

Dawn Austwick: In 2016-17 when we set our budget, we were still operating on an LDF forecast of £1.8 billion, so we set our budget in accordance with that. As the year progressed, income levels fell. One has to be careful about making choices too quickly because it was not clear whether we were in a trend situation, but we at all times monitored where we were in terms of funds flowing out. As it happens, we reduced the amount of money that we had planned to pay out a little bit to recognise that, but we looked very carefully and we felt confident we could still meet all our commitments, which indeed we can.

Q60 **Chair:** Can I go to you, Ms Owen? It seems the income is dropping from the lottery and yet the liabilities for each of the distributors are getting bigger. Is that situation sustainable and is it something that your Department is concerned about?

Sue Owen: We are certainly very alive to the issues here. All our lottery distributors are very experienced at managing stocks and flows. Dawn has talked to you about how some of the commitments are multi-year and there is not a lot you can do about them in-year, but I think everybody is now being cautious looking forward. It is also true to say that in the good years they were not committing up to the extent of the increase in income in those years, so the management has been very good. But we are all concerned about the long-term impact if there is a sustained decrease.

The lottery is integral to much of my Department's agenda. The thing we all have to do is to work together to try to make sure that the remaining years of this licence period are as good as they possibly can be, and that we maintain the positivity of the brand. If some projects that have begun cannot be finished, that is really quite serious. Some HLF capital projects—heritage capital projects—require multi-year funding. If they cannot be finished we will not get the main benefits of them, so we all have to pay a lot of attention to this, and it is definitely high up my Department's risk register.

Q61 **Chair:** If you look at figure 12 on page 29, the gap between the liabilities and the income is as wide as it has ever been. There is a rather alarming statement in paragraph 3.17: "For one distributor, the cash-flow forecast showed its Fund balance falling to nil in 2020 if its current award programme remained unchanged". So there are some alarming trends going on out there. What further action might your Department take to address these?

Sue Owen: We meet very regularly, on a bilateral, trilateral or all-four basis, with the lottery distributors forum. We are sharing more information. That came up quite a bit in the NAO Report. We have this more sophisticated model that we asked the Gambling Commission to commission. Once they upgrade their model to take account of the new changes that Camelot are bringing in—the quality of the information that our lottery distributors are getting is now better than it was in the past. We have very good people on the boards of our lottery distributing bodies, who are watching all this like a hawk.

Q62 **Chair:** You talk about better information. It seems that a lot of the information comes from Camelot, and you get it on a weekly basis, but you are not distributing this information on a weekly basis to the distributors. Why is that? You are basically giving them just historical data, which may or may not give a good projection of future trends. Why don't you give them this weekly data?

Sue Owen: We give them real-time monthly returns from the national lottery distribution fund, because that also includes income from interest, unclaimed prizes and so on. They get weekly sales data from Camelot, but three months in arrears, and they can then see trends in that. Our view is that real-time weekly data is quite volatile and would not add very much. There is quite a lot of real information that they are getting to enable them to plan properly.

Q63 **Chair:** But given that you have just said—and it is obvious—that the distributors are very sophisticated in what they do, if the weekly information is available to you as the Department, what is the harm in giving it to the distributors? The weekly data may be volatile, but it may also identify longer-term trends.

Sue Owen: Our view is that it would not be helpful.

Q64 **Chair:** Okay. Do you have a comment on that, Ms Harrison?

Sarah Harrison: Not other than to say that the work that we are doing around the econometric model, which has had its first run, will over time be an improved, more sophisticated approach, because it will borrow many of the features that you see in classic Bank of England fan diagram approaches to what low, medium and high scenarios might be. The inputs to that model are a combination of what we know and understand in terms of how the lottery and the range of products are working, and we are trying to factor in the additional factors, like impact of competition and dynamics in the market. We have run that model out for the first time. A fresh version of it will be available by the end of March.

We will inject into that, as the Permanent Secretary said, some of the numbers you have heard from Nigel and some of the projections from the strategic review; and then, with a degree of periodicity, one would expect that model and those projections to be available, and to be improved on over time. I think that is a much more stable and sophisticated basis for forward funding.

I should make the point, as a regulator, that that is also very important from our point of view, because it is another way in which we can look at Camelot's performance in the round and understand whether the commitments it is making and the projections it is setting actually come true. So it is helpful from a regulator's point of view, as well as, obviously, from distributors' point of view.

Q65 **Chair:** You have been the regulator for quite a while. Why has it taken over 10 years to act on this Committee's recommendation that more sophisticated modelling of future good causes income be given to distributors?

Sarah Harrison: All I can say, not having the benefit of hindsight, is that the fact we are now putting this in place, working with the Department, drawing on their support and, as part of that, fostering good engagement, including with distributors, through organisations like Dawn's, means that we are in a stronger place, in terms of putting this forecasting model in place. The challenge is that we have to learn from the past, but more importantly, we have to put our efforts into making this model work effectively for everybody in the future.

Q66 **Chair:** So this new economic modelling is really important from two points of view: one, so that the distributors have a better handle on how much they are able to distribute in future; and secondly, so that you can identify long-term trends quicker, so that you know where you need to start negotiating the licence when it is up for renewal. How will you keep testing this economic model to make sure that it works better?

Sarah Harrison: The economic model plays one part, the inputs into it, but there are other things that the Gambling Commission does—looking at trends in participation, which were talked about earlier, and market analysis, which we will do as part of this early preparatory work for the next licence competition, and that will paint a richer picture beyond what we already have about how this market is evolving. I would not want to rest solely on this forecasting model, but it will certainly bring more to the picture than is presently the case.

I would also point to the fact that, additionally, within the existing licence framework we are putting in place, as of April, a new evaluation framework. That will pick up a series of different KPIs that we will discuss and that we worked on with Camelot, so that we can track in a number of areas and much more clearly, their own performance at a more granular level than is available even through the forecasting model. There are at least two additional things there that will help the existing work that we already do in relation to looking ahead and analysing trends.

Q67 **Chair:** So when and if this Committee or the National Audit Office revisits this subject, they will be able to test your economic modelling and the mechanism that you just talked about to see how well it has worked.

Sarah Harrison: Yes; there will be the forecasts and then there will be what is observed in terms of what has actually happened.

Q68 **Chair:** So how long will we need to give it to see whether it is actually working properly?

Sarah Harrison: I am very happy to consider that question carefully and come back to the Committee if it is helpful to you completing your inquiry.

Q69 **Chair:** Would you do that? We always like to know when it is likely that we may be revisiting a subject or not, so that would be really helpful.

Sue Owen: Perhaps I can just add that it is also very helpful for us to understand a little bit more about what all the other factors are. For example, in this model, competition from society lotteries does not come out as a significant variable.

Q70 **Chair:** I was going to come to that. Would you like to address that, because I was going to ask you whether we ought to be deregulating the other lotteries?

Sue Owen: There is the issue of the market and increased competition from other lotteries. That does not come out as significant in this model at the moment. Take the betting on EuroMillions, which is not particularly significant. It is quite small: if all the sales of EuroMillions were diverted onto Lotto, good cause returns would not even be up by £1 million. Even so, they are exploiting a loophole in our legislation by betting on the national lottery games, and we are introducing secondary legislation to ban that.

Society lotteries definitely have potentially a bigger impact. In this model, at the moment, they do not appear to be directly affecting Lotto or other sales. At the moment they are generating £500 million of sales a year, which is nothing like enough to explain the shortfall that we have seen in lottery income, and at the end of the day society lotteries do return money to good causes at different rates: for the Health Lottery it is about 20%, for the People's Postcode Lottery it is about 30% and for the sector as a whole it is about 40%.

Nevertheless, the sector has grown a lot—10% or 11% annual growth rate—over the past 10 years, and if that continued it could get to a scale where it starts to impinge on the national lottery. We do not know about how saturated the market could get. So this model will help us to see whether in time sales of society lotteries are actually diverting from the national lottery.

Q71 **Chair:** The evidence you will have seen from the Lotteries Council confirms what you are saying. They do not believe that society lotteries have a material effect on the main lottery, and therefore they are suggesting that increasing the limits on society lottery revenue raising could generate more income.

Sue Owen: Well, that is a policy question that we are currently looking at. The Digital, Culture, Media and Sport Committee has done a report on that. The Government are looking at it. Our feeling is that there is not a very significant impact on Lotto at the moment, but I am very alive to the concerns that Camelot has that it could get there.

Q72 **Chair:** Can I move on to the changes that you made to the main lottery fund, Lotto? Mr Railton, what were those changes in terms of the cap on the main lottery? Why did you put it up and then bring it down? What was your thinking on that? It seems to be totally contradictory thinking. I am wondering how much that has led to the psyche of people reducing their spend on the main Lotto.

Nigel Railton: Do you mind if I come back to the society lottery issue at some point during the meeting? I have a point of view.

Chair: Of course.

Nigel Railton: On the Lotto game, the first change was made to Lotto in 2013. Lotto had been in perpetual decline for a number of years. In 2013, when the price increased from £1 to £2, Lotto was declining at a rate of about 8%. To do nothing to Lotto in 2013 was not an option. The price of the Lotto was increased from £1 to £2. The price had not increased for 21 years. That was the right thing to do, in my opinion, because it offered more prizes and value back to players. The price has not changed since then; What has changed is that in 2015, the matrix was changed from one in 49 to one in 59. The idea behind that was to increase the size of the jackpots. The general feeling in lotteries is that if you get bigger jackpots, more people play. Initially that was quite successful, but in 2016-17 it was not. That contributed heavily to our disappointing year in 2016-17.

Part of my strategic review was on what we do with Lotto. What we did first was consider it as part of a portfolio. It has to have a clear place in the portfolio. The jackpots on Lotto were getting too big. They were getting too close to EuroMillions, and Lotto was not differentiated enough. Our Lotto players—there are still 12 million a week playing regularly—are saying, "Don't change the game too much. We don't want any more disruption. What we want is clearer prizes and a better winning experience, and we want the jackpot to be shared more evenly." We put that into all our research, and we are now close to a final game design that we will be looking to relaunch in October. Clearly I cannot discuss what those changes are, because I need to approve them with Sarah first.

Q73 **Chair:** Nevertheless, when you reduced the number of combinations from 59 to 49, you also increased the cap from £50 million to £55 million. You then suddenly drastically brought that cap down from £55 million to £22 million, which seemed to indicate an entire change of policy. Why were those fairly drastic changes made?

Nigel Railton: I have to be honest; I was not involved in the business at the time, so I do not have the explanation for that, but I am happy to come back with it. I think the logic was that the Lotto jackpot rolled to £56 million at its peak, and the problem is that when jackpots roll to a really big number, they reset people's expectations. We see that with EuroMillions and around the world. The US is a great example: the Powerball can roll to $1.5 billion, and then people do not start playing until the jackpot is $500 million. It resets expectations. The reason for reducing the jackpot from £56 million down to £22 million was to try to reframe expectations and to get the jackpot won more frequently. Rather than allowing it to roll beyond £22 million, at that point it must be won, or it will roll down if not won.

Q74 **Chair:** I understand the rationale for doing it, but it does seem to me that at one point you wanted to increase the total amount of the jackpot and then suddenly you had a change of heart and decided that you wanted to reduce it but make more people win it. You cannot have it both ways; it is either one or the other. I wonder why there was a complete change of thinking. Ms Harrison, your commission agreed this with Camelot. Why was there this sudden change of heart?

Sarah Harrison: Events as Nigel has described them are clearly right. From our point of view as the regulator, at the time that the changes were made—the addition of 10 more balls, the change in the matrix and the kick-up in the jackpot—the evidence that Camelot was presenting was that in order to create more enthusiasm and excitement around the game and to increase the prize pay-out and the jackpot opportunity, that was the right way to go. The evidence immediately showed that, because we saw that massive roll series. Notwithstanding 2016-17's performance, which was clearly very disappointing, we saw that bumper year in 2015-16—the highest for the lottery to date. But then it became evident that the roll series was going on for quite a long time and it was affecting win belief. Our challenge to Camelot was, "Have you got your strategy right?"

Correspondingly, quite rightly, the business looked at what was going on. You were seeing participation decline, and therefore they came forward with a series of different proposals, ultimately bringing forward the proposal to bring the prize jackpot down. That was the one we approved, and the reason for that was, as Nigel articulated, that the effect was to reduce the series of rollovers and therefore create a must-win moment and correspondingly restore some win belief.

If you look at where we are on trading right now, Mr Chairman, notwithstanding that this is still very disappointing relative to previous years, some of those actions have sought to stabilise both sales and returns to good causes. Where we sit right now, Camelot's performance is 8% up in comparison to the forecast for 2017-18. While there is absolutely a long way to go, none the less some of those actions have stabilised some of the decline, which of course is important, albeit not sufficient.

Q75 **Chair:** I want to bring in the Comptroller and Auditor General.

Sir Amyas Morse: I just wanted to come back to one question, as I listened interestedly to the regulator in particular. Is what you are saying that you are comfortable with the growth in Camelot's profitability, notwithstanding how well or badly it may have performed? You are comfortable with the level of growth and profit it has had over the past period of years, are you? That is appropriate considering the performance of the fund, is it? I want a clear answer, rather than a formulaic one. Are you comfortable with the amount of extra money Camelot is making and whether it is doing a good job or a bad one? I am not suggesting it is doing a bad job; I am just trying to be clear whether you really think that whatever you are doing adds up to a satisfactory split of the cake between Camelot and the fund. Is that what you believe?

Sarah Harrison: Where profit sits at the moment is 1%, in contrast to what was expected when the licence was granted in 2009, which was 0.6% of sales after tax. It has increased from where it was and from where the regulator at the time expected it to be. We do not regulate the rate of return. That is not a feature of the existing framework, and I think there is a good question, as we approach the next licence and the next form of regulation, as to whether we should consider that.

Sir Amyas Morse: But, allowing for you not regulating it, I am asking you a quite direct question. Are you comfortable with that rate of profit growth as against the performance of the fund?

Sarah Harrison: If you look at the events most recently, it is difficult to see how one can be comfortable, given that sales have reduced in the way that they and returns to good causes have. Over the life of the licence, to get a further answer on that, one wants to benchmark that rate of profit against other similar regulated assets—not just those in other classic regulated sectors, which are probably more asset-heavy, but trying to find a class of assets that are more comparable to Camelot—to judge whether that is a reasonable rate of return on an asset like this over that contract period.

Sir Amyas Morse: The bit I pick out of that, which I am going to cling on to, is that you are not comfortable. Thank you very much.

Q76 **Chris Evans:** Mr Railton, you have seen a 122% increase in your profits over a seven-year period. At the same time, moneys to good causes have only gone up by 2%. How would you justify that to someone who believes they are buying a ticket that will go to a local good cause?

Nigel Railton: Maybe I can explain a bit of context, explain what has driven the profit growth, and then come back to the good cause comparator over that period, if that is okay.

The context to this is that when we bid for the third licence, because we bid very competitively, we always anticipated starting the licence at very low levels of profit. We talk in the NAO Report about £181 million of investment. It was actually £140 million of investment in 2007-08 for transition, before the licence even started. That was the shareholders' investment in transition, which by the way will happen again in the next competition that happens. It was £140 million in years minus 1 and 2 before the licence started. We always intended to start profit really low and grow it over time, in line with sales, because we were confident we could grow sales. We started at £32 million. In fact, the year afterwards we dropped to about £28 million. This is on a £140 million pre-investment with a view to growing sales.

If I then think about how profits grew by £39 million, from £32 million to £71 million—percentages can be misleading when you are comparing millions and billions, but none the less the figures are correct—between the first year of the third licence and 2016-17, there were really three drivers of that. One was the change in corporation tax from 28% to 20%. That drove about £9 million of that increase. About £15 million of the increase was down to the £1.5 billion sales increase between 2009 and 2016-17. In fact, if you take it from the last year of the second licence, it was nearly £2 billion. Finally, about £15 million of the increase was due to productivity savings, which were partly enabled by the renegotiation in 2012 to extend the licence. That has allowed more secondary contributions to be shared with good causes.

The other really important part of the equation is the capital investment that has been made. To the end of 2016-17, our shareholders had invested £322 million in capital. That is the £181 million that is in the Report and £140 million before that, give or take rounding. We are continuing to invest at a rate of about £25 million a year. That is £25 million last year, this year and planned for next year. In our bid submission, which I guess was a comparator to the early-years licence, we anticipated that we would be investing about £2 million in capital at this point. Even in the extended licence submission, we anticipated investing about £5 million. Our shareholders are now investing about five times the level of capital they anticipated investing. That extra profit has allowed those investment decisions to be made.

Q77 **Chris Evans:** How has the capital investment you have talked about, which is about 8,000 new terminals, related back to sales?

Nigel Railton: That is part of it. Of the £322 million up to the end of 2016-17, about £80 million was due to the increase in the estate. In 2011 we identified untapped demand in the UK that required about 8,000 new terminals to access.

Q78 **Chris Evans:** If I may be so bold as to say so, Mr Railton, you are a monopoly. You have no direct competitors. You are putting on record profits. The first principle of the founding of the national lottery by the Government in 1992 was to raise money for good causes. Do you honestly believe, given the profit you are taking and the fact that the good causes are dropping, that you are living up to that 1992 aim of raising money for good causes?

Nigel Railton: I have go back to the context point.

Chris Evans: I don’t want context; I want a yes or a no.

Nigel Railton: But it is important. Camelot is now operating at 1% profit, which I do not think is unreasonable when you consider the level of capital investment. To the end of 2016-17, profit attributable to shareholders was £422 million on a £322 million investment. Camelot and the national lottery had been in growth from 2003 to pretty much 2015-16—pretty much perpetual growth. Yes, there has been one disappointing year. The other bit of context is that, as Sarah mentioned, good causes are 30% higher under the third licence than they were under the second licence. Yes, there was a disappointing year in 2016-17, but that should not distract from the success that the national lottery has been.

In terms of whether we are a monopoly, that is an interesting question. We have talked about the impact of society lotteries and competition. One of my findings from the strategic review is that the market has changed significantly. Society lotteries have grown by 200% over the last five years, enabled pretty much by the industrialisation of society lotteries. We could have a debate about whether they are directly impacting our sales, but there are forces at play that are increasing the competitive pressures in the market.

Let me give you one example of that. From a marketing perspective, when we launched the third licence in 2009, we had a 90% share of voice for lottery, so if you saw a lottery ad, it was probably ours. We are spending the same amount of money now, and we have a 43% share of voice. In the last two years, our share of voice has decreased by 25%. We are getting outspent by our competitors—these industrial-level society lotteries. We were outspent in 2017. They spent more than us despite having 4% of our turnover. How? Because our competitors either do not pay tax or do not pay good causes. That is a structural issue that we face. I would argue whether we are actually a monopoly.

Q79 **Chris Evans:** I would say that you are in a far more favourable position than society lotteries. You have certain restrictions on your industry that allow you to create large amounts of profits. Of course you will be a success—you have no competitors, do you?

Nigel Railton: We have competitors.

Q80 **Chris Evans:** You said earlier that society lotteries have no impact on your business.

Nigel Railton: To be fair, the Permanent Secretary said that; I did not. I think that they do, but I will not get into a debate here. There is definitely evidence of factors. Let me give you another example: betting on lottery products was prevalent last year—at one point you could hardly turn on your TV without seeing an advert for one of those players. That has forced digital media inflation for us to levels that we could never anticipate. On Google, we were paying 40p a click to be the front search on EuroMillions. By the end of last year we were paying £5.50 a click. That is the level on inflation on our own products. That is having an impact.

We are competing increasingly in the leisure and entertainment industry for the pound in people's pocket. The gaming and gambling market in the UK has virtually doubled GGY over the last five years. That has reframed people's expectations. We are competing in that market and in the lottery space, which is becoming more competitive. That share of voice is something that we need to think about structurally. We need to think about how we respond to that.

Q81 **Chris Evans:** I'm sorry Mr Railton; I don't buy it. I worked in the betting industry 20 years ago. There was betting on the Irish lottery and the 49s, which I think are still released in the shop every week anyway. You had all those pressures for numbers of years: why all of a sudden are these a problem for you?

Nigel Railton: Twenty years ago it wasn't a problem—the National Lottery was founded in 1994—but the market has evolved. You have been in the betting industry so you will know that the GGY in the gambling industry has nearly doubled over the last five or six years. The amount of marketing spend in this market now is enormous.

Our share of voice is now about 12% in the wider gambling and gaming market that we are now considered to be part of. If you go back seven years, we were a much bigger proportion of that. Even in our direct market—the lottery market—we are 43% share of voice. We have lost 25% share of voice in two years. That is a structural problem that policy needs to think about for the next competition. We cannot compete with the structural benefits of some of our competitors.

Q82 **Chair:** I will bring in the National Audit Office again.

Paul Keane: We have in figure 5 of the Report the figures from 2016-17. I have heard some of the evidence given by Mr Railton, but the sales of Lottoland betting in 2016-17 were £15.5 million, in the context of National Lottery sales of £6.9 billion. That gives a sense of the true numbers in terms of the degree of competition.

Nigel Railton: To be clear, I am not saying that that is the only factor. It is a contributing factor. Those market forces are a contributing factor in why good causes have declined.

Q83 **Chair:** Can I try to get at this a different way, through you, Ms Harrison? You have heard from Mr Railton that he has a windfall profits benefit of £9 million. He has made a £15 million increase in reducing costs—in efficiencies. Would your note to your successor say that you should be looking at the level of his profitability when the amount of money going to good causes is falling? Surely, there must be a very clear case for your successor looking at that.

Sarah Harrison: I would encourage my successor to look at three things in the course of setting the framework for the next licence.

Chair: You anticipate my question, but can we stick to this specific question?

Sarah Harrison: One of those is that: what is the right approach in setting a regulated rate of return for an asset such as this? There are other things: what is the right term of a contract? What features ought to be there to allow for reopeners in certain circumstances? There are a number of things about the framework that will benefit from being looking at by my successor.

Chair: Thank you.

Q84 **Chris Evans:** A final question for you, Ms Harrison. Based on Camelot operating as a monopoly, do you think it was a mistake not to factor in some cap on profits in the last licensing run?

Sarah Harrison: Hindsight is a wonderful thing. The regulator at the time set an incentive framework that includes a cost-sharing mechanism and the incentive framework around driving sales and performance. It calculated broadly what it might expect to see in terms of profits at Camelot from that, which was roughly 0.6% of sales overall after tax. It is now at 1%. In fact, the area to speak of disappointment about or to be less comfortable about is what happened at licence renegotiation in relation to the cost-sharing arrangement, because that did not favour good causes—it actually favoured Camelot. There are some benefits in return from that, certainly including for good causes, but that has been the main driver of profits to date.

In answer to the Chair's question, a number of things need to be thought about for the next licence, including what the appropriate approach is to rates of return and, incidentally, in relation to outcomes—what is the expected outcome in terms of sales, good causes and so on from a regulated monopoly asset such as this?

Q85 **Chair:** I have a final question for you, Ms Owen. We have already skated over this area. I am sure that you have seen the evidence from GambleAware. I am concerned about the switch to scratchcards and instant cards with quite significant instant prize money to be won. I understand the restrictions on the number of times you can play them and everything else, but is that something that your Department is looking at? Might we see some change in regulations to deal with it?

Sue Owen: It is definitely something that we are looking at. You know my Minister, Tracey Crouch, is the Minister responsible for gambling. She is very interested in these issues. I will not to say that we will definitely do something about it, but it is definitely something that we are looking at.

Chair: That's very kind. I thank you all very much for your attendance this afternoon. It has been most informative. I am grateful to you all for attending.

Footnote:

Q4: The 44% and 31% figures are accurate, but relate to participation in all draw-based games, not solely Lotto.

Q16: Paragraph 5 reads "for every pound that Camelot saved, roughly 30p went to good causes, whereas 70p went to Camelot". This is directionally correct and was qualified appropriately as being a high level summary.

However, to ensure accuracy, it should be clarified that this ‘sharing arrangement’ only takes place for windfall profits (driven by the cost savings) over and above a certain level. The specific formula is that Good causes take 28% of any profits which are more than 20% above the levels anticipated within the Third Licence.

Q17: In response to Q17, paragraph 2 reads “Even post-renegotiation they are 32% up on pre-renegotiation, so good causes have benefited”. This is a slight miscommunication. Post-negotiation annual average returns are 32% up against the Second Licence, not the pre-negotiation period of the Third Licence.