

# **Statement following consultation on Business Plan and Budget 2021/22**

23 March 2021

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## 1. Consultation process

1.1. Our draft Business Plan and Budget 2021/22 was put out for public consultation on 10 December 2020, with a deadline for comment of 21 January 2021.

1.2. We have received five consultation submissions:

- Phone-paid Services Consumer Group
- Telefonica UK (O2)
- aimm (Association for Interactive Media and Micropayments)
- Telecom2
- Action 4

1.3. We have reviewed each submission in detail and our responses in respect of the publishable submissions are set out in section 2 of this document. They are based on our understanding of the points in each submission that are relevant to the Business Plan and Budget, and our responses should be considered alongside the respective consultation submissions, which are published separately alongside this statement.

1.4. As a result of the consultation, we have amended the Business Plan and Budget 2021/22. These changes are detailed in section 3 of this document.

## 2. PSA response to consultation comments

### 2.1. Phone-paid Services Consumer Group (PSCG)

2.1.1. We thank PSCG for its response and note that its introduction contains a range of observations not directly related to our Business Plan and Budget for the 2021/22 year. We will continue to engage with PSCG to discuss the issues raised, but would note here:

- while our primary aim for the development and implementation of Code 15 is to prevent harm from happening in the first place, we also aim to enhance our ability to address harm quickly within due legal process and the principles of good regulation. This will include increasing the effectiveness of our ability to suspend services and impose withholds of income.
- there is no statutory or other sound legal basis that would allow us to mandate that services can only be provided by UK companies, or to hold Level 1 providers legally accountable for the actions of their clients (irrespective of their geographic location)
- specific services referred to by PSCG within their submission are subject to investigation by the PSA
- it is not within our remit to impose a requirement on network operators to put in place a bar on third-party charges as a default
- we welcome the support indicated for the increased emphasis we are placing on due diligence, risk assessment and control (DDRAC) and our recent levels of consumer engagement.

2.1.2. With regards to our planned activity for 2021/22, we note PSCG's support for the development of the 15<sup>th</sup> Code of Practice ("Code 15") but also the concern that bespoke agreements would allow the ill-intentioned to get round stricter requirements. We would reassure PSCG that the broad intention of including the possibility of bespoke arrangements in the new Code is to allow alternative means of meeting standards and requirements but with an equivalent level of consumer protection. The Code 15 consultation process will allow for this point to be considered further.

2.1.3. We note PSCG has no comment on the proposed budget for 2021/22.

2.1.4. PSCG raises the role of fines with regards to the levy and expresses the view that the "cost of regulation should fall most heavily on those who break the rules" – and this is indeed the approach we have followed historically, with collected fines used to offset the amount of levy required. What has changed in recent times is that in dealing with the most egregious cases of non-compliance, our adjudications have largely been against companies who had no intention of being reputable players in the market and liquidated rather than face up to their responsibilities. With an emphasis in Code 15 on prevention rather than cure, our aim is to ensure that such unscrupulous companies are unable to gain access

to the market in the first place. This means that, notwithstanding how any collected fines in the future will be used, the levy should increasingly be viewed as the cost to industry of effective regulation and ensuring consumers are well served through a healthy market that is innovative and competitive.

2.1.5. We note PSCG is of the view that the estimated size of the market for 2021/22 is realistic.

2.1.6. We thank PSCG for its specific comments on how we can improve the consumer content of our website, and we will consider them as part of our activity plans for 2021/22, which include developing our consumer education and engagement more broadly. We will be continuing consultation and engagement on Code 15 and expect to hold further consumer webinars in the future. We also note PSCG's expectations around how we communicate with consumers regarding the progress and outcome of investigations, and we will look further at how we make information available. Finally, we would reassure PSCG that we do monitor social media for consumer comment, but issues reported directly to us are more useful as evidence of harm that we can act upon.

## 2.2. Telefonica UK (O2)

2.2.1. We thank Telefonica UK for its submission and note the broad agreement “with the prospective and retrospective assessment set out in this consultation”.

2.2.2. We note Telefonica UK’s concern regarding the availability of accumulated fines, and that we appear “to forecast that no further fines will be collected in the forthcoming year”. We would ask Telefonica UK to note:

- the specific wording we use is “accumulated fines available to offset the levy”, which is not the same as an expectation that we will not collect fines during 2021/22
- we held individual discussions with each Mobile Network Operator (MNO) last year regarding the impact of the increased levy requirement in 2021/22, recognising that they are responsible for collecting over 90% of the levy on our behalf. We subsequently wrote to the MNOs collectively in July 2020 to explain that we would apply an unadjusted levy funding approach in 2021/22, and that Code 15 would provide further opportunity for our funding arrangements to be consulted upon.
- within this communication to MNOs we explained that should any material levels of fines be collected during 2021/22, we will take this into account through the year-end reckoning up process with all MNOs (adjusting for over or under payment of the levy during the year)
- we have taken this approach because while we could provide an estimate of funds that may or may not turn out to be collected in 2021/22 and use that to offset the initial levy requirement, that runs the risk that we would require substantial, unexpected balancing figures from funders at the end of the year. We also believe there to be a significant risk of this arising, since we prudently assume that our enforcement activity will primarily continue to bear down on those unscrupulous providers with no long-term legitimate commitment to the market, and who therefore attempt to liquidate rather than face up to their responsibilities and seek to continue as viable businesses.

2.2.3. With regards to Telefonica UK’s comments on the budget allocation for 2021/22:

- we would reassure Telefonica UK that our budget is a “bottom-up” costing of the activities planned for the year, which includes some rebalancing of staff resources – for example, we expect the nature of gathering intelligence about the market and individual services to indeed change, and staff roles will reflect that
- our budget for legal fees is set to ensure we have sufficient resource to pursue robust debt recovery, e.g. dealing with liquidators; identifying and making claim to assets; pursuing legal redress; making enquiries into other jurisdictions etc. We decide on a case-by-case basis the likely benefit or return from devoting more funds or resource to pursuing a specific debt,

but would note that in general, further significant expenditure in this area does not typically lead to a material additional recovery of fines.

- we will amend our plan to include consideration of our office size and location beyond our current lease, especially once the longer-term implications of the pandemic are understood on operating models.

2.2.4. We do not agree with Telefonica UK's view that "levy funds would be more prudently spent ensuring that non-compliant operators are suitably sanctioned for non-compliance, reflected in an adjusted levy for compliant operators that remain in market". Our approach to enforcement is not, nor should not, be driven by financial considerations, and indeed our Code Adjudication Tribunals must be able to consider and apply sanctions solely on the merits of the cases placed before them.

2.2.5. We note that Telefonica UK has no comments on the estimated size of the market for 2021/22.

## 2.3. aimm

- 2.3.1. We thank aimm for its submission and understand that it represents the varying views of its members.
- 2.3.2. We note aimm's view that our plans for 2021/22 are based on an "erroneous assumption that the PSA need £4m to maintain the integrity of this marketplace", a view we understand is derived from research it has carried out on regulatory models in other territories. We do not think this research and the conclusions being drawn from it are relevant to the UK market, for the following reasons:
- the research is making comparison with industry self-regulation models. The UK's approach to premium rate services is governed by the Communications Act 2003, which includes the requirement at section 121(2)(b) that Ofcom should only approve a Code of Practice for the regulation of the market if the organisation operating the Code is "sufficiently independent of the providers of premium rate services". It is difficult to see how a self-regulatory model on the lines advocated by aimm would be consistent with that requirement.
  - the research provides no real detail about the legal basis for the regulation in the territories surveyed. It neither details the legal underpinning that allows for self-regulation nor does it provide any detail on the legal/contractual arrangements that make them work.
  - as importantly, there is very strong evidence that industry self-regulation is not appropriate for the UK market. There is a long history of significant harm and specific incidents or reasons for that harm which have not been adequately addressed by industry measures, ranging over time from consumer harm caused by internet diallers to internet-based subscription services offering various forms of content. We also note that the Payforit scheme was originally set up by MNOs with the intention of not needing regulatory oversight - indeed the MNOs argued for it not to be included in the PSA's remit. However, it ultimately failed to provide the level of protection that consumers expected and needed, with exploitation of the weaknesses in the scheme by unscrupulous industry participants leading to a highly damaging impact on the brand and the scheme being withdrawn. It has taken strong regulatory intervention to deliver a major reduction in harm.
- 2.3.3. With regard to activity concerning fine collection in relation to the size of the levy, we note the persistent view of aimm members that non-collection of fines "cannot be considered effective delivery by the regulator". We disagree strongly with this view which implies a lack of effort or effectiveness on the part of the regulator, when in fact difficulties in collecting fines are driven almost entirely by the behaviour of non-compliant providers. We have set out our approach to fine collection previously and would also remind aimm members that:



- our experience of recent years shows that serious non-compliance has almost exclusively been carried out by providers with no long-term legitimate commitment to the market, and who often attempt to liquidate rather than rather than comply with regulation, deliver good services to consumers and seek to continue as viable businesses
- it is often clear in serious cases that it will be difficult to recover fines even before the case reaches a Tribunal. The Tribunal however has to consider cases on their merits. In reaching a fair and proportionate decision, it cannot be driven by the potential risk that a provider may not pay an imposed fine, nor can it consider the funding requirements of the PSA.
- we continue to rigorously pursue debt collection through all legal means, so that every avenue is explored to hold providers to account (see also our response above at 2.2.3 to Telefonica UK on this point).
- fines are an important sanction available to the Tribunal to act as a means of deterring non-compliance, but not the only one. Where fines are not paid, we will usually seek to prohibit the provider or individuals behind it from the market, preventing them from continuing to cause harm to consumers. Furthermore, in order to ensure consumers of phone-paid services are protected more broadly, we also share information (where lawful and appropriate) with other relevant regulators to allow them to consider enforcement measures that extend beyond our remit.

2.3.4. We note aimm’s assertion that “the proposed budget for 21/22 is unworkable for industry” and that “at a regulatory cost of £4m per annum, the industry is not sustainable”. We also note however that no evidence is provided by aimm to support this assertion, and would make the following broad observations about the cost of regulation and the size of the market:

- the cost of regulation (i.e. our budget) has been £4m for the past 6 years, and has been reduced by £1m in real terms since 2015/16
- consumer spend in 2015/16 was £544m (excluding charity donations) and has grown to £606m in 2019/20.

2.3.5. aimm state that some of their members “neither understand or agree with” our position on the costs of regulatory activity in relation to complaint volumes. We are happy to provide further clarity on our position:

- we are a regulator and not an ombudsman, and therefore complaint handling only forms a small part of what we do, with the Business Plan and Budget 2021/22 setting out the full range of activity required in our role as a regulator. A reduction or increase in complaints does not have a direct impact on the resources required for all other functions.
- the numbers of complaints to us either about specific services, service types or in aggregate provide an indicator of levels of harm in the market. However, the number of complaints does not necessarily correlate precisely with harm, with other sources of intelligence providing information about harm and non-compliance in the market,

- in addition to this, the numbers of complaints we receive do not correlate either with the numbers of cases that we deal with, either informally or through formal application of the Code. We would also observe that keeping the budget to £4m means we still only have sufficient enforcement resource to deal with a subset of eligible cases.
- the range of regulatory activity we need to undertake is not only a function of harm in the market, it is also related to the potential for harm (and as set out in our objectives for Code 15, our aim is to move much more towards the prevention of harm in the first place). Recent incidents in the market demonstrate that harm can arise from technical failings and not just bad actors, and our recent emphasis on due diligence, risk assessment and control shows that the industry is lacking in this area and requires regulatory intervention.
- as evidenced by the consistent nature of our budget, the cost of regulation has not risen in years when complaint numbers have increased substantially. However, should we achieve a long-term reduction in complaint numbers to a sustained low level, we will of course review the overall nature and level of resources required to maintain a healthy market. At the moment, given the history and recent instances of serious non-compliance and harm in the market, we do not think this is prudent in the short term.

2.3.6. We note aimm's request for a "detailed schedule of how costs are spent". Our view is that the schedule of activity as set out in section 4 of the Business Plan and Budget, alongside the budget breakdown included at Appendix A, is more than reasonable. While there is no impact on the budget in 2021/22, we will however amend our plan to include reference to our ongoing consideration of our office size and location beyond our current lease, especially once the longer-term implications of the pandemic are understood on operating models.

2.3.7. We have communicated extensively in advance of this Business Plan and Budget that the amount of levy required from industry would increase in 2021/22, as a consequence of the amount of available collected fines falling to zero (and not as a consequence of an increased cost of regulation). We have discussed the impact of this with each of the MNOs, who are required to collect the levy on our behalf and taken the opportunity to review the current funding model with them. The conclusions of this approach were:

- confirmation that the Code only allows for the levy to be collected by Network Operators (and not aggregators or merchants), whether they choose to pass this on down the value chain or bear the cost themselves
- a range of alternative calculations of the levy alongside other potential funding models were considered, but none were deemed to be either workable in practice or able to deliver a fairer apportionment of the levy
- therefore the current model was to remain in place for 2021/22, but (as set out at 6.7 of the Business Plan and Budget) with an adjustment so that the

year-end reckoning-up process eliminated any over or under recovery of the levy required

- the consultation process for Code 15 would allow for fuller consideration of our funding arrangements.

2.3.8. In addressing aimm's comments regarding the impact of the increase in the amount of levy required, our position remains clear:

- we regulate in the interests of consumers, and the level of activity set out in our Business Plan and Budget is the minimum required to achieve this
- the cost of this activity has been tightly controlled in recent years and is a constant £4m. We remain committed to identifying and applying efficiencies wherever possible, but a materially reduced budget will mean that we are not able to meet the statutory requirement for effective regulation. In that instance, it would be up to Ofcom to decide how the statutory requirement for sufficiently independent regulation had to be met.
- ultimately the level and nature of participation in the phone-paid services market is a commercial and strategic consideration for networks, aggregators and merchants alike. We want to ensure consumers are well-served through supporting a healthy market that is innovative and competitive – but we will not do this by reducing the levels of necessary regulatory activity for the financial benefit of industry.

2.3.9. We note that while aimm's submission makes some observations about factors affecting some of its members, it does not offer an alternative approach to estimating the size of the market (as measured by outpayments from Network Operators) for 2021/22. We also note aimm's view that the impacts of the pandemic make it more difficult to rely on historical trends and data, which we acknowledge, but would observe:

- our estimate is cautious and prudent, taking the lower end of the range of the calculation based on the latest quarterly data available
- there are clearly some long-term trends that are continuing to hold true – mobile continues to increase as a share of the market, voice-based services continue to decline
- some digital services, e.g. streaming services have grown strongly against an overall background of sharp economic contraction.

2.3.10. Section 3 of the Business Plan and Budget is a review of the current year, and the draft was written with a view to what will have been completed by March 2021. In response to aimm's point about data reports, by that date we will have completed our review of the data we acquire and hold about the phone-paid services market, including:

- what data we will make available
- the purposes for which we will make it available
- how we will make it available.

2.3.11. aimm's assertion that it has launched a website to provide support for consumers as an alternative to the PSA spreading good news about the industry is puzzling and seems to us to be contradictory. As a regulator, our primary interest in this respect is to ensure that consumers have good and reliable information. We also note that aimm asked for, and received, permission to link to content on the PSA website, including our Service checker, recognising its value. We welcome industry initiatives that provide genuine support to consumers. However, we also note that it is in the industry's own interest to provide that support and build confidence, especially given the relatively low opinion consumers have of phone-paid services as evidenced by the low Net Promoter Scores published in our Annual Market Review.

## 2.4. Telecom2

- 2.4.1. We thank Telecom2 for its submission.
- 2.4.2. With regards to our plans for 2021/22, we note that Telecom2 assumes our workload will be reduced because complaints are lower. This assumption is not correct (see our response to aimm at 2.3.5 above), and the activity plan set out in Section 4 of the Business Plan and Budget takes into account the impact of recent regulatory action in successfully reducing consumer harm.
- 2.4.3. Telecom2 raises the issue of our fines and their impact, suggesting that they should be set at a level to make them “collectible and unlikely to deter innovation”. In addition to the points made in 2.3.3 above, we would also observe:
- Telecom2 refer to Ofcom’s penalty structure, and their understanding that “5% of revenue was an effective deterrent”. While our understanding is that Ofcom’s penalty structure actually varies between contraventions, with regards to percentage of revenue this is in relation to a firm’s overall turnover and not just revenue earned from a service under investigation. We do not have the power to impose fines at this level, but agree that such a level should be an effective deterrent for reputable companies.
  - the impact of substantial fines on a company adjudicated against is assessed as part of the consideration of proportionality by Tribunals. In common with other regulators, the Tribunal also considers whether it is necessary to remove the financial benefit to the company arising from the breaches in question and also the need for the fine to be set at a level which acts as a deterrent to others in the market. Reasoning is clearly set out in the published adjudications.
  - we do not agree with the assumption that innovation could lead to breaches of the Code, unless that innovation is being designed by providers to specifically exploit consumers. Otherwise, we look forward to continuing to engage with industry to ensure compliant new ideas are brought to market for the benefit of consumers.
- 2.4.4. We note Telecom2’s view that we should take action against communications service providers. This is largely outside of our remit, with the Code only enabling us to take action with regards to any due diligence, risk assessment and control failings in their role as terminating networks.
- 2.4.5. We note Telecom2’s reference to the research conducted by aimm, and refer to our analysis at 2.3.2.
- 2.4.6. With regard to consumer education, the Business Plan and Budget provides an overview of the activity we already are committed to undertaking in this area. However, we would emphasise that with regards to issues raised by consumers,

our starting point is to consider the information and decide whether to investigate further, rather than engage in dialogue on social media.

2.4.7. Telecom2 make a number of observations about our budget, and we are happy to provide additional clarification to the explanations given in section 5 of the Business Plan and Budget:

- with regards to staff costs, the budget for 2021/22 also reflects our recent benchmarking of salaries at all levels to ensure we are able to attract and retain the quality of staff we need to deliver our business plan. Therefore, while we have reduced our overall headcount, the cost of the remaining staff mix needed to deliver our regulatory activity is in line with market rates for the roles we have.
- we will amend Appendix A of the Business Plan and Budget to split the analysis of “Overheads” between finance and governance costs and other overheads. In doing so, it will be apparent that the increase referred to is in fact to do with unavoidable finance and governance costs in relation to insurance premiums and the cost of the audit undertaken by the National Audit Office<sup>1</sup>.
- the depreciation budget line includes the costs of the expected necessary capital expenditure required to keep our technological capabilities up to date, while all the costs shown under IT systems and Telecoms are non-depreciated running costs.
- with regards to office costs, we refer to 2.3.6 above.

2.4.8. We note Telecom2’s comments regarding the impact of the increase in the amount of levy required are similar to those of aimm, and we therefore refer to the points made at 2.3.8 above.

2.4.9. Telecom2 observes that the size of the market “could be adversely affected by the Covid pandemic”, and that some companies may drop out of the market due to economic difficulties but does not offer an alternative estimate. We refer to 2.3.9 above.

2.4.10. We note that Telecom2 “would like to see more contemporaneous reports on complaint volumes”. In addition to our comments in 2.3.10 above, we have full regard to data protection legislation and our responsibilities as a data controller, and this will inform what reports we make available and how, in the future.

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<sup>1</sup> As a public sector body we are audited by the National Audit Office. The PSA is not free to choose a different auditor.

## 2.5. Action 4

- 2.5.1. We thank Action 4 for its submission.
- 2.5.2. With regards to our plans for 2021/22, we note Action 4's support for our ongoing commitment to engagement and transparency with industry. We also note the recognition for our work in developing Code 15.
- 2.5.3. Action 4 has consistently raised the issue of our office location being in London, and we will amend our business plan to include consideration of our office size and location beyond our current lease, especially once the longer-term implications of the pandemic are understood on operating models.
- 2.5.4. As in previous years, Action 4 asserts that the value of the market for 2014/15 was £763.7m. This figure is inaccurate - the market size (as measured by outpayments from networks) for that year was £443.6m<sup>2</sup>, and therefore lower than the estimated figure for 2021/22. However, we do not in any case believe our budget should correlate to the size of the market, either up or down.
- 2.5.5. We would reassure Action 4 that we do indeed look at costs very carefully, and that the budget is annually built "bottom up" to ensure that the cost of regulation is the minimum it needs to be for the activity required. As with the size of the market, we do not believe our budget correlates just with the measures of actual harm that Action 4 lists. A lot of our policy work, industry engagement and informal enforcement activity seeks to deal with the potential for harm, and indeed our aim for Code 15 is to move much more towards the prevention of harm in the first place.
- 2.5.6. We note Action 4's concern that the figure for accumulated fines available to offset the levy in 2021/22 is shown as £0. This figure is correct, for the following reasons:
- the fund of collected fines will have been fully consumed by the end of the current 2020/21 year, having been used to deliver a consistent levy requirement of £1.8m over the previous 4 years
  - the nature of the providers adjudicated against in recent years means that fines have proven to not be collectible – and so this fund has not been replenished
  - rather than provide an estimate of funds that may or may not turn out to be collected in 2021/22, we have prudently assumed that our enforcement activity will continue to bear down on those unscrupulous providers with no long-term legitimate commitment to the market, and who attempt to liquidate rather than face up to their responsibilities and seek to continue as viable businesses

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<sup>2</sup> As per Network Returns submitted for that year, excluding any prior year adjustments for inaccuracies

- in any case, we have discussed this with the Mobile Network Operators, who are responsible for collecting over 90% of the required levy on our behalf. Should any material levels of fines be collected during 2021/22, we have agreed to take this into account through the year-end reckoning up process with all Network Operators (adjusting for over or under payment of the levy during the year).

2.5.7. With regards to the estimated size of the market for 2021/22, we have presented quarterly figures for the different sectors of the market, and a prudent estimate in the round of the likely size of the market for both the current 2020/21 year and the 2021/22 year on which the unadjusted levy percentage is based. We note that Action 4 do not offer an alternative estimate of the size of the market.

2.5.8. We agree with Action 4's desire for "effective, proportionate and best value regulation", and manage our cost base along those lines. In terms of further scrutiny, we are audited by the National Audit Office and our filed annual accounts are a matter of public record and are available from Companies House.



### 3. Finalised Business Plan and Budget 2021/22

3.1.1. After full and due consideration of each of the consultation responses received (as set out in section 2 above), we have identified the following changes to the draft Business Plan and Budget 2021/22:

- at 4.6.3 we have added a specific reference to our ongoing consideration of future office requirements
- at Appendix A we have provided additional clarity by splitting out “overheads” into “finance and governance” and “other overheads”.

3.1.2. We have also conducted a full internal review of the draft Business Plan and Budget 2021/22 written in December 2020, and have concluded that there are only minor changes needed to arrive at a final version:

- we have made the following changes to described activities:
  - at 4.1.4 we have clarified how bespoke regulatory approaches may be identified and considered
  - at 4.3.2 we have clarified our aims for the use of automated channels to contact us
  - at 4.4.3 we have replaced “data strategy” with a better description of precisely what we mean in this section
  - at 4.6.4 we have included specific reference to data protection as part of delivering robust and professional legal oversight.
- we have made grammatical changes where relevant.

3.1.3. The final version of our Business Plan and Budget for 2021/22 is published alongside this statement and follows approval of our budget as £4,087k by Ofcom. It contains confirmation of the levy at 0.83% of outpayments for 2021/22, based on estimated outpayments of £470m from network operators to their industry clients.