Peter Barker
Phone-paid Services Authority
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27 January 2021

By email only to: pbarker@psauthority.org.uk

Dear Peter,

Phone-paid Services Authority's (PSA) consultation on business plan and budget for 2020/21

Introduction

1. We welcome the opportunity to comment on the PSA's proposed budget for the 2020/21 financial year.

2. As the PSA is aware, we are Telefónica UK (TUK), a wholly owned subsidiary of Telefónica S.A. We are a leading provider of retail mobile services and one of four mobile network operators (MNO) in the UK. We offer communications solutions to over 33 million consumer and corporate customers through our O2 and giffgaff brands. We are also the MNO of choice for a number of mobile virtual network operators, including Sky and Tesco Mobile.

3. Additionally, we play an important role in the provision of phone-paid services. We are a provider of technical platform services that enable Level 1, and by extension Level 2, providers to deliver phone-paid services to customers. We engage with both Level 1 providers and customers, offering a billing facility by which our O2 customers can pay for digital content, donate to charities or cast television program votes by charging the costs to their mobile bill. This additional revenue is passed on the funds to Level 1 providers (who in turn pass on the revenue to Level 2 providers).

4. We broadly agree with the prospective and retrospective assessment set out in this consultation. We therefore do not comment in great detail on each of the PSA's observations and proposals. Instead, this response sets out our

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particular concerns about the PSA's proposed budget. Responses to the PSA's specific questions are set out in the Annex below.

Availability of funds from enforcement action

5. In its proposed budget, the PSA has explained that the funds of historic fines and administration charges have now been exhausted. Additionally, the PSA appears to forecast that no further fines will be collected in the upcoming financial year. As a consequence, no adjustment will be made to the levy in 2021/22[1].

6. Whilst we understand why the PSA's historic savings have been exhausted, we are concerned and surprised by the suggestion that it does not expect to obtain any further funds from enforcement action in 2021/22.

7. The PSA has made clear that it will continue to enforce Code 14 as per previous years. This includes taking on at least '100 of the most serious cases' through its various enforcement Tracks[2] and issuing fines in line with its penalty guidelines. In our estimation, the PSA's Code 14 enforcement strategy has resulted in the PSA issuing over £3.5million in fines since January 2020. Its most recent enforcement action concluded in a fine of over £885K. Given the PSA's enforcement strategy is not due to change until the next financial year, it reasonable to assume that similar outcomes will be achieved under its 2021/22 enforcement program. It is therefore strange that the PSA does not expect to issue or collect further fines in the upcoming financial year.

8. We are concerned about the insinuation that existing and potential fines going uncollected in 2021/22 as it could have unintended consequences. The purpose of enforcement action and statutory sanctions is to act as a disincentive to malicious and non-compliant behaviour. It ensures that the gains from non-compliance do not outweigh the risks. A suggestion that no fines will be collected in the upcoming financial year (or indeed that the PSA expects to be unsuccessful in collecting fines) undermines that deterrent. Such an approach will ultimately result in compliant providers being penalised for the non-compliance of others through an increased levy – as seen in this proposed budget.

9. In our view, the PSA's stance is incongruous with its commitment to implement a legally exhaustive debt recovery process for unpaid fines and admin charges. The PSA must provide clarity on whether any of these fines have been collected or are expected to be collected in the next financial year. If collection has taken place (or is expected to take place), then the PSA should explain why these collected fines are not contributing to an adjustment in the levy for 2021/22.

[1] PSA Business Plan and Budget consultation – para. 6.4 and para. 6.6 (table). The PSA has forecast £0 for contribution of accumulated fines to adjust the levy.
[2] PSA Business Plan and Budget consultation – para. 4.5.3

More explanation is required on the PSA's rationale for budget allocation in 2021/22

10. We welcome the PSA's decision to provide a high-level breakdown of its operating budget. However, in our view, further clarity is required on how "staff" and "premises" costs are allocated and why the PSA continues to allocate a large proportion of its budget to these cost areas. Collectively, 81% of the PSA's operating budget is allocated to "staff" and "premises" costs. These are significant sums that have a tangible impact to the industry levy payments.

11. In our view, these are costs that can (and should) be reduced over time, reflected in a reduced levy. Conversely, such funds should be reallocated to ensure that they are used more effectively. This is particularly pertinent given the 2021/22 levy remains unadjusted due to no income from enforcement action.

12. As the PSA acknowledges, complaints have continued to reduce since 2019 – the market is becoming increasingly compliant and healthy[3] and network operators have introduced robust onboarding and compliance monitoring programmes. In our experience, this suggests that less PSA resource should be required to address complaints and undertake market monitoring (staff costs). Instead, we have seen an increase in staff costs of approximately 5% to 10% over the last four years. This has coincided with a 65% reduction in the budget allocated for legal fees and debt recovery over the same period. We find this prioritisation puzzling, especially given the debt recovery challenge faced by the PSA at this time.

13. Likewise, COVID-19 has demonstrated that the PSA (like many organisations) can effectively work from home. Whilst we acknowledge that premises costs are fixed for this period, we are keen to understand whether the PSA has a strategy to reduce costs in this area given COVID-19 and the lack of receipts from enforcement action.

14. In addition to this, we anticipate that many of the initial proposals in set out in the PSA's Code 15 discussion paper will drive substantial cost into the market. For example, new IT systems could be required to address the PSA's new information gathering powers or enhanced DDRAC requirements. As we have made clear to the PSA, [✂].

15. We urge the PSA to provide a clearer rationale for its budget allocation in 2021/22. In particular, we would like to understand why considerably more resource continues to be dedicated to staff and premises costs as opposed to legal and debt recovery. In our view, 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.

[3] PSA Business Plan and Budget consultation – para. 3

Impact of COVID-19 and Brexit

16. In its prospective view of the market, the PSA has stated that it expects the market to continue to be dominated by Operator Billing services, with a corresponding decline in traditional voice-based premium rate services.

17. As we have already addressed in our Code 15 Discussion Paper response, COVID-19 has had a disruptive impact on the premium rate services market and customer behaviour has been inconsistent throughout the pandemic. Whilst we have observed a historic increase in demand for Operator Billing driven by app store services, growth is now modest. The signing up of new merchants has stagnated and we have not observed any new, larger blue-chip organisations entering the market. Furthermore, we have observed an overall increase in demand for PSMS and other voice-based premium rate services, underpinned by substantial increase in the use of voice services across the market.

18. We are yet to observe the full impact of COVID-19 and Brexit on the payments market, and it is vital that the PSA continues to monitor and adjust to changes in the market. This includes making appropriate adjustments to the levy.

Kind regards,

[✂]

Regulatory Manager – Telefonica UK (O2)

Annex

Q1. Do our plans for 2021/22 sufficiently deliver our role as a regulator? What else do you think we should be doing or not doing?

As set out in the response above, we are concerned by the PSA's suggestion that it will not collect fines from enforcement action in 2021/22 and that this will result in an unadjusted levy. In our view, this punishes compliant providers by imposing on them higher levy payments and does not create the right incentives for non-compliant providers to change their behaviours. It is incongruous with the PSA's commitment to implement a legally exhaustive debt recovery process for unpaid fines and admin charges. This is not in the consumers' interest, nor the market's, and we urge the PSA to provide clarity on whether any of these fines have been collected or are expected to be collected in the next financial year.

Q2. Do you have any comments on the proposed budget for 2021/22? If you recommend any changes, please clearly identify which areas of activity you expect this to impact upon.

As set out above, the PSA should provide a clearer rationale as to why greater resource is being dedicated to "staff" and "premises" costs, rather than to legal and debt recovery activities. The PSA has acknowledged that it faces a debt recovery challenge, which has sparked a review of its debt recovery strategy as part of Code 15. It is therefore puzzling to us that the budget for legal and debt recovery activities is being reduce (65% over four years).

In our view, 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.

Q3. Do you have any comments on the proposed levy for 2021/22?

We recognise that the unadjusted levy has remained fairly constant over the past few years. However, we are disappointed that the PSA does not expect to adjust the levy in 2021/22 due to funds from enforcement action being unavailable. In our estimation, the PSA's Code 14 enforcement strategy has resulted in the PSA issuing over £3.5million in fines since January 2020. Its most recent enforcement action concluded in a fine of over £885K. Given the PSA's enforcement strategy is not due to change until the next financial year, it reasonable to assume that similar outcomes will be achieved under its 2021/22 enforcement program. It is therefore strange that the PSA does not expect to issue or collect further fines in the upcoming financial year.

We urge the PSA to provide clarity on whether any of these fines have been collected or are expected to be collected in the next financial year. If collection has taken place (or is expected to take place), then the PSA should explain why these collected fines are not contributing to an adjustment in the levy for 2021/22.

Q4. What is your view on the estimated size of the market for 2021/22?

We have no comments on this issue.

Q5. Do you have any other comments on the Business Plan and Budget 2021/22?

We have no further comments on the business plan and budget.