Submission to PSA

Review of phone paid subscriptions

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Review of Objectives

We agree with the objectives as set out in section 34 with the following comments.

High-level comments about our response, based on our areas of expertise and knowledge

We generally separate Direct Carrier Billing from billing based on Premium SMS. The reason for this is that PSMS usually doesn't require user consent to charge, which can make it problematic. We generally refuse to work with MT billed SMS and have little experience with it. Our comments are primarily focused on Direct Carrier Billing (DCB).

The words "product" and "services" are often used interchangeably, but we prefer to use the word "service" in the context of subscriptions. The nature of a repeat payment implies an ongoing service relationship with a customer.

Our business has focused on a relatively narrow band of services and we can comment knowledgably about our own area of understanding. We define this area generally as socialised entertainment. It includes socialised content (encouraging interaction, comment, discussion and discovery of digital content – used effectively within sport supporter clubs, television networks etc.) It also includes generic social environments such as chat and dating. Our responses are generally drawn from our understanding of this market, not the entire payments market.

Q1: Our Views on the objectives set out in Clause 34

Consumers having the confidence to use phone-paid subscriptions that they want.

We suggest a stronger position. Rather than just creating confidence, the objective should be positive promotion of DCB as the best and most trusted option for any customer. Where existing payment methods are in place and accepted for subscriptions, (such as app-store, credit card, bank payments, Google Pay and Apple pay), Carrier Billing should be aggressively promoted as the best and most trusted option for the customer. Subscriptions are now commonplace across a number of service categories and the subscription model is undergoing almost explosive growth. The DCB subscription model appears to be lagging behind in this period of rapid growth. Direct Carrier Billing has a competitive edge in some areas, but not others. Establishing the nature of this competitive matrix would be very useful in establishing not just trust, but enthusiasm.

The market is thriving and innovative.

This objective is agreed. As commented above, for a number of reasons, DCB is being left behind in the growth of the subscription economy.

Consumer interests are furthered through encouraging competition and innovation.

Generally agree. Encouraging innovation is paramount to creating a vibrant market. We also extend the use of the term "innovation" to the topics of regulation and compliance management. However, we don't fully understand the context of the word "competition". Does this refer to competition with other payment methods such as application stores and credit card, or is this internal competition between services within the DCB ecosystem? We would prefer the industry's focus to be on competition with other payment methods. Competition internally, such as between services within similar categories, will happen naturally.

There is the ability for existing services to operate effectively as well as for new services to enter the market.

We agree very strongly with this comment and link it with the comments above. The current DCB industry is stifling both innovation and ability for new participants to enter the market.

There is compliance with the regulatory framework for subscriptions. This means that consumers are protected from harm in the market.

We agree. Management of compliance has become a very complex picture and needs to be addressed at a number of touch points.

Some subscriptions generate high levels of complaints, whereas others with similar numbers generate relatively few.

This is a question that requires honesty from the industry to answer. It is very clear that a number of products and services sold via Carrier Billing have simply been cynical, deliberate and systematic attempts to rip off customers. These are the participants who have been creating the high level of complaints. This issue is a global phenomenon. They are also the participants most skilled at understanding and bending the compliance frameworks. We should also make it very clear that the problem of deception and fraud is not limited to Carrier Billing, but occurs across all e-commerce frameworks. Carrier Billing stands out in this sea of bad merchant behaviour because the relationship the customer has with their mobile service provider is very different to the relationship with the credit card provider. If a customer finds suspicious charges on their credit card account, they are unlikely to blame the credit card company and seek redress directly from the merchant. If the same transaction occurs, under the same circumstances, but on a mobile bill, the customers will immediately blame the mobile carrier. The customer does this because they believe the mobile carrier will assume more responsibility than a bank. This is both a threat to the sustainability of DCB, but also suggests a raft of opportunities for mobile carriers to positively exploit this service relationship they have with the customer and the enhanced level of value added support they bring to transactions.

We encourage the continued use and evolution of a 'principle based' compliance framework that focuses primarily on customer outcomes rather than a prescriptive rule-based structure. We would also encourage comparative research work to be done in payment methods and e-commerce systems outside Carrier Billing. Both official and anecdotal evidence suggests that customer protection is much better within the Carrier Billing industry than other ecosystems such as credit card e-commerce. However, the customers are much less tolerant to issues within Carrier Billing.

We believe that managing merchants and vendors requires close attention to the customer outcomes at a fine-grained level and at the earliest possible point in the value chain. This would require information to be provided directly by merchants about short, medium and long-term metrics. We expect that provision of relatively simple metrics collected by merchants and verified third party analysis would solve many issues in the industry.

We also encourage the adoption of a "Gold Standard" best practice document that establishes a small number of mandatory behaviours from the merchant. Attached is a slide deck, presented to the Global Carrier Billing Summit, that describes these and other methods we would suggest for a successful ecosystem.

It is clear that the industry comes under attack from bad practices inside the advertising channel. In this case, not only is the customer victim, so is the merchant. We believe it is not uncommon for well-intentioned and honest merchants to become the target of fraudulent activity.

Q3: Do we agree that different subscription services may require different regulatory responses? What would this look like?

We can only agree with this proposition if a specific condition is met.

This condition is simple. All subscription services must be treated equally until they prove themselves, by measured performance. Under these circumstances, we would then support introduction of performance-based regulation.

The only measurements that can be used must be empirical. It is important that application of different regulatory responses takes away any qualitative assessment. This qualitative assessment of services will have the wrong outcomes.

The only valid empirical data is (in order of importance) 1) Complaint rates 2) Refund request rates 3) Retention. It was suggested recently that engagement should be a measure, but engagement is not an empirically valid measurement. This is because no reliable benchmark can be established to measure optimum comparative engagement between services.

If any service proves itself, through positive outcomes against these measures, it would then be elevated to a different regulatory status – but must continue to perform. Services that perform to the contrary would move to less. The existing £4.50 threshold is a positive initiative, but is not sufficient to determine the final customer outcome.

We would favour a relatively light touch regulation to new entrants, followed by close scrutiny of short-term performance factors. The most applicable short-term measurement is churn, which can be measured and reported on daily.

Our reasoning for this approach is that the industry must be careful to not punish service providers for simply being new. This would be contrary to the stated goals of encouraging new services, new entrants and innovation.

Q4: Is there any other information?

There are a number of publications that describe the growth of the subscription economy. These include the recent book "Subscribed" by Tien Tzuo.

As explained above, we believe the occurrence of fraudulent activity targeting honest merchants is high.

The two channels carrying the largest amount Internet fraud are Google and Facebook. No one is immune! Sources of information on Google and Facebook ad fraud are varied and numerous.

The industry punishes merchants for this behaviour, but this is an area where much more support from regulators is required by way of education and access to fraud protection tools.

Fraudulent activity in the industry: In our opinion DCB is a very safe and customer friendly payment method, typically better than credit card payments.

In recent times it has, like many other industries, been struck with digital fraud problems. We believe DCB has better chances of dealing effectively with fraud than any other payment method. Unfortunately Carrier billing fraud gets disproportionality higher scrutiny and publicity than other types of on-line fraud.

If the Carrier Billing industry thinks it has a fraud problem, we should be aware that it is miniscule compared to other types of on-line fraud, which amounts to 1.5 trillion dollars each year. (Source - Dr. Michael McGuire, Senior Lecturer in Criminology at the University of Surrey, 2018)

Additional notes on Direct Carrier Billing subscriptions

As explained above, we only endorse DCB. In our view PSMS is flawed and is not a viable safe transaction method. DCB represents the payment method with potentially the highest protection to customers, in comparison to credit card-based systems. If customers are properly educated and informed by the industry, it provides more safeguards than any other payment type, and generally low transaction values.

As an industry, we may become introspective and forget that other payment methods suffer much worse events in terms of fraud and deceptive behaviour. The scale of dishonesty and deception across the Internet is overwhelmingly bigger than this behaviour on Direct Carrier Billing. The following bullet points identify some of the pertinent differences, which we must consider as advantageous.

1) **Small transaction increments:**
Direct Carrier Billing generally uses low increments of less than £10. In comparison, Internet fraud is characterised by large fraudulent transition increments. Very often, credit card fraud involves transactions amounting to £1,000's.
2) **SMS receipting:**
The most powerful communication tool in the Direct Carrier Billing arsenal is SMS. Most Internet payment systems use email as the communication channel for receipts, which is inferior to SMS, alerting the customer that a transaction has occurred.
3) **The STOP command:**
The Internet world would be a very different place if all the customer needed to do to cancel a subscription to anything was simply send an email with the word STOP in the header. Our research on internet subscriptions shows a very difficult and convoluted cancellation process.
4) **No long-term commitments:**
Very often, subscriptions signed up using credit cards bind the customer to ongoing contracts, or prepayment agreements. It is common practice to ask a customer to commit to 6-12 monthly payments in order to reduce the purchase price. Most current Direct Carrier Billing agreements are casual 7-day small increment commitments which can be cancelled at any time.
5) **Fully refundable transaction:**
Carrier Billing is a commercial anomaly. Generally, other payment methods prohibit or seriously limit refunds. Carrier Billing offers full refunds to customers on request, regardless of the reasons for the request.
6) **No tokenisation:**
Tokenisation is the method used in Credit Card payment gateways to store customer-billing data securely to be re-used for recurring or additional transactions. This enables the merchant to bill at any time without future customer consent. Tokenisation in credit card payments is very useful as in enables us to bill Uber rides at one click – but it also represents a serious fraud channel when used dishonestly. With a credit card token system, a fraudulent merchant can charge the customer any amount at any time. DCB does not allow any further charges to be made, over and above the agreed subscription price, without full consent from the customer.

7) **Singular customer support channel:**
DCB is the only transactional model that leverages an existing service provision relationship. The carrier is not just a payment channel like a credit card company; they are a provider of a number of communication and digital services to their customers. They have customer support infrastructure in place to manage these products and customers have an expectation that any transaction on their account can be dealt with via this support channel. There is no equivalent in the banking industry.

Q5: Do we have any other market experience?

We have had experience in two other markets, Australia and USA. These were not positive experiences. We believe these markets failed for a number of reasons. We also believe the UK market is progressing well towards putting the correct safeguards in place to ensure a viable market. The simple failure points of both USA and Australia market were:

- Emphasis on prescriptive rules rather than measuring customer outcomes. Generally, this created a mood where the best cheats, not the best services, won.
- Lack of fundamental framework management. As an example, in both these markets, merchants were not required to have clear and obvious information pages and brand presence. There was no equivalent of the service finder.
- Lack of support by carriers into customer support. Despite very large revenue, the carriers typically had no resource customer services staff to answer subscription enquiries properly.
- Lack of investment by carriers. As above, there was typically very little investment into gathering data about the activity, which meant internal questions could not be answered.

We also have had experience working with credit card payments in the sales of physical products on-line. It is this experience that opened our eyes, as a company, to the extreme level of fraud and deceptive behaviour in the credit card payments and advertising industry.

Further comments:

In our opinion, the structure of the Carrier Billing framework in most countries is fundamentally flawed. This flaw dates back over 10 years and became an institutionalised flaw. The L1 and L2 structure puts a payment aggregator between the carrier and the merchant. However, the actual transactions occur between the merchant and the carrier's customers. The aggregator is not resourced, skilled or capable of managing the relationship between carrier and merchant. This is one of the contributing factors in the breakdown of carrier billing markets.

Mechanisms that give the merchant and carrier a stronger dialogue would benefit the industry greatly. These are the two parties who receive the greatest income from services. The L1 earns minimal margin from sales and should not be expected to be the primary communication channel. The use of the name "aggregator" is a misnomer, as it tends to imply some sort of content management role.

There is a true need in the DCB industry to look at the structure of the framework. The obvious action Is to strengthen the area of on-boarding vendors so that this is faster, safer and more effective.

We see opportunities for content aggregation platforms/service providers to resolve the key issue described in clause 27.

Background to Lateral and payment experience

Lateral has had 18 years' experience in the sale of mobile product and services.

The company worked closely with several mobile phone companies including Vodafone., Telstra, Optus, Spark (NZ), T-Mobile US, Bell Canada and Rogers Canada.

Lateral has primarily used non-subscription methods such as pay-to-use, one-off purchase, and freemium models. These models were typically used when working with very strong and visible product distribution channels such as Carrier Portals and TV networks.

The subscription model is used whenever the company has to market the product directly to the customer. We have found that the only model that is viable under these circumstances is subscription.

Lateral only uses DCB for payments. It has trialled MT billed Premium SMS in some markets for subscription payments but strongly prefers not to use it. In fact, Lateral believes MT billing using PSMS should not be allowed in any market, except under very specific controls. Any method that can bill a customer without Consent to Charge should not be allowable.

Lateral has also used and continues to use PCI compliant credit card payments for some aspects of its e-commerce activities, including subscriptions. Lateral does not use credit card payments for products otherwise sold via DCB. The higher friction of credit card payments forces the customer price higher and encourages a more aggressive sales funnel. In the addendum we show a table of comparative pricing in one industry we have done a pricing study.

Our view on the subscription model

We are in the middle of a worldwide shift, across all industries, to a subscription or recurring payment model. The first industries seeing this shift have been digital content and media companies, but we are now seeing subscription payments appear in non-digital industries. The recent move by auto manufacturers, such as Mercedes, Porsche and Volvo to offer non-ownership subscription usage models, is a notable example. SkiHi based in California booking provides a subscription service which allows subscribers to book flights for free.

Without any doubt, the subscription ecosystem is enjoying massive adoption.

Commodity vs special interest subscriptions

Subscriptions for commodity services like power, water, telephone are commonplace.

Customers with subscriptions for commodity services like power, water, telephone are likely to be reliant on the commodity and the industries will become price sensitive.

We are now also seeing music and videos entering the commodity space, encountering price and margin pressure.

In the future, we can expect to see of a worldwide shift, across all industries, to a subscription model.

Direct Carrier Billing has a small place for commodity subscriptions but does not compete effectively with credit card billing. It will continually be under price and margin pressure.

DCB offers the greatest revenue and margin opportunity for special interest content and services. DCB's advantages hold the key for its growth. In the comparative pricing study annexed below, we show the benefits that DCB offers customers in one target industry.

The future of DCB is not about simply converting customers of an existing service, from one payment method to another. This would place the industry at a competitive disadvantage against other low cost payment methods, such as credit card. DCB cannot compete on price with credit card and the carriers will be burnt off in a race to the bottom if competing for the business of products such as Netflix, Spotify and the app-stores.

Rather, we believe that the future of DCB lies in the creation of innovative new products and services, optimised for the specific attributes of DCB. Lateral expects to be one of the companies seeking the opportunity to innovate within these specific traits and assisting other businesses to do so also.

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Is DCB the next great disruptor?

We believe that the entire application market is ripe for disruption and the disruption can easily come from the combination of mobile web, header enrichment and DCB.

The concept of downloading an application to get access to content is contrary to the rest of the digital industry. This manufactured ecosystem, constructed by carrier unfriendly forces, was built to shut out the mobile carriers from the content and payment business.

There is no need to download an application for most products and services, no need for the customer to only buy from Apple or Google, and no need for the credit card to be the primary payment method on mobile devices.

The web contains vastly more content and opportunity than the app-stores but has suffered because there is no native payment system. As the web has become mobilised, this payment system has developed. There is nothing to stop the development of independent app-stores, built to sell mobile-web content and using DCB as the native payment system. The advent of AI and machine learning systems, that assist customers with product discovery, will also benefit DCB more than the app stores.

It appears to us, that this is the biggest commercial opportunity for digital content the world has ever seen. It will enable many more merchants than just Apple and Google to participate. It is the basis for a rich, diverse and vibrant economy.

We fully expect to hear the words one day… "Do you remember the time where you had to download an app from Apple to get this stuff?"

We believe the UK market has the best intentions and contains the most promising elements to create the start of this disruption. Our company is more than happy to work with the PSA as a protagonist for creating this disruptive opportunity.

Annex 1:

A real world analysis of a typical DCB based sales against credit card based sales of similar digital products.

Our own product sector intersects with on-line dating apps and services. Our comparative study showed very different approaches to marketing and on-boarding customers, between credit card and DCB.

This study was initiated after a number of queries from carriers and partners, asking why our company did not have a registration first flow "…like the on-line guys do".

The study identified the very aggressive and deceptive marketing tactics of the on-line dating services.

The signup to the on-line dating services is not a true sign-up, it is simply the start of an aggressive marketing funnel. Once the customer enters the tunnel, which is usually deceptively described as free and unlimited, they are then encouraged very aggressively by email blasts, fake users and special offers to get them to subscribe.

At the point of subscription the initial charges and commitments are much higher than DCB based services.

Because we all exist in the somewhat introspective world of carrier payments, we are often unaware of the true processes and consumer traps in the on-line payment world.

The comparative study is in additional slides that will be sent separately to this document.