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

Dear Gavin,

Phone-paid Services Authority's (PSA) discussion paper on developing the next PSA Code of Practice

Introduction

1. The Phone-paid Services Authority's (PSA) discussion paper sets out its approach to reviewing its regulatory framework, its key objectives and the scope of its review ahead of the decisive consultation. We welcome the opportunity to engage with the PSA's proposals at this early stage and shape the way in which the Code is reviewed, improved and updated.
2. We agree that the time is right to review the PSA's Code of Practice and the regulatory framework that underpins it. The Code plays a fundamental role in ensuring the effectiveness and integrity of the phone-paid services market. In our view, it is imperative that the Code delivers the right outcomes for our customers, and ultimately all consumers¹. This review provides an opportune moment to explore whether the existing framework adequately addresses consumer harm in the market, and whether existing obligations incentivise the right behaviours from suppliers. We therefore recognise the importance of this market review and are committed to engaging with the PSA throughout this review process.
3. 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

¹ Like Ofcom, the PSA has a statutory duty under the Communications Act (2003) to further the interests of customers (Section 3(1)) and ensure that its regulation is not unduly burdensome (Section 6(1)).

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.

4. 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 programme 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).
5. This discussion paper is very broad in its scope and, in many instances, lacks detail. It covers a wide variety of proposals that will have a large impact on all levels of the phone-paid services value chain. In our response below we set out our high-level concerns about the PSA's initial proposals. We do not comment in great detail on the specifics of each proposal, and we reserve our position until more detail is provided in the PSA's full consultation – due in Autumn 2020.

The PSA's market assessment is broadly correct, but incomplete

6. In its discussion paper, the PSA sets out at length how it (and Ofcom) has observed developments in the telecommunications market, and specifically the phone-paid services market. In summary, the PSA observes that there has been a general market shift away from voice and SMS/MMS to the use of data and over-the-top (OTT) applications. This general market trend has been mimicked by the phone-paid services market, as voice-based services have declined (Directory Enquiries, PSMS and premium voice), and operator billing has substantially increased². The PSA expects this trend to continue over the coming years, with continued growth of operator billing driven by MNOs and large blue-chip organisations³.
7. We broadly agree with the PSA's market assessment; its general conclusions are uncontroversial and well-established. For example, we have also seen a large increase in demand for our operator billing services in recent years, driven predominantly by app stores. Similarly, we have also observed that complaints regarding subscription services [X].

² PSA – Developing the next PSA Code of Practice, para 103

³ PSA – Developing the next PSA Code of Practice, para 173

8. However, we do not believe that the assessment is complete as it currently fails take account of the views and plans of firms participating in the market. The PSA has based its market assessment on complaints received by the PSA, Ofcom analysis and market research conducted by a variety of independent research groups. However, it has not included contributions from MNOs, Level 1 and Level 2 providers. We find this position puzzling, especially as the PSA acknowledges the fundamental role played by mobile operators in shaping and developing the phone-paid services market. The PSA's market assessment is ultimately one-sided.
9. As a continued example, whilst we have observed a historic increase in demand for operator billing driven by app store services, [REDACTED].
10. We have also seen a [REDACTED], suggesting that harm to consumers in this area is already being addressed by the market.
11. This has predominantly been driven by our recent introduction of an offline verification step [REDACTED].

Figure 1: [REDACTED].

[REDACTED]

12. Data and observations from the mobile operators could provide important insight and context to the information obtained independently by the PSA. This context, which can only be provided by mobile operators, plays an important role in explaining *why* certain trends are emerging. In preparing for its full consultation the PSA should consider evidence of market trends and customer harm presented by MNOs, Level 1 and Level 2 providers.
13. Similarly, strategic information volunteered by mobile operators and larger blue-chip organisations could provide the PSA with an important insight into how they see the market developing. This is an approach regularly adopted by Ofcom, which it used heavily in its recent Fixed Telecoms Market Review (FTMR)⁴. Given the influential role that mobile operators and larger Level 1 and Level 2 providers have in determining market trends, it would be prudent for the PSA to consider the views of these operators before coming to a conclusion on how the market has, and is likely to, develop.
14. The PSA should also re-evaluate the phone-paid services market in light of the COVID-19 pandemic. Whilst we had observed some modest demand growth in PSMS prior to COVID-19 lockdown, there has subsequently been

⁴ As part of its assessment, Ofcom looked at the established plans of alternative infrastructure providers to gauge the extent to which new networks would materialise over the review period. This was based on board papers and information submissions provided by the relevant Communication Providers (CPs).

significant increase in demand, predominantly driven by broadcast competitions. Similarly, we have seen a substantial increase in the use of voice services, especially for conference calling services. From [X]. Evidently, this trend is at odds with the overall decline in voice services observed by Ofcom, the PSA and industry prior to COVID-19⁵.

15. In our experience, this increase in voice service usage will likely coincide with an increase in harm stemming from premium voice services (many of which are high value). As seen in [X].

Figure 2: [X].

[X]

16. Many complaints received are high value complaints regarding either PSMS or non-geographic numbers such as information, connection and sign-posting services (ICSS)⁶:

*"I have been charged for making a phone call to O2 but I was unaware it was the international number [X] it was just the number I was given and I was on hold for 60 minutes my phone bill is normally £50 something and O2 have took out **£86.60** from me which I'm really not happy about because that's my money I need for my baby boy's milk & nappies I want a refund. "*

17. The PSA has been clear that its Code of Practice, Special Conditions and Guidance must be fit for purpose. We agree, and in our view, this involves close consideration of the harms that arise from *all* parts of the market. It is not sufficient or proportionate, especially in the context of COVID-19, for the PSA to simply observe that the premium voice market is in decline and therefore by extension harm is also declining. Conversely, it is not the case that because Charge to Mobile services are increasing, harm is also increasing on these services. A clear and cogent theory of harm is required.

⁵ PSA – Developing the next PSA Code of Practice, para 103 – “087 and 09 are also declining, with revenues falling by 41% year-on-year between 2017/18 and 2018/19”

⁶ Please note, this is one example of many voice-related complaints. Complaints vary considerably in value and volume.

An overly prescriptive approach to regulation risks distorting market outcomes

18. The PSA has proposed that its Code should move from being a broad outcomes-based approach to a more prescriptive, rules-based approach⁷. The rationale for this change in approach is that the current system is complex and requires piecemeal clarification through enforcement action.
19. We welcome the PSA's recognition that the Code can, at times, be unclear and difficult to comply with. We agree that there is merit to moving to a regulatory approach that offers providers will greater clarity ex ante.
20. However, the move to an approach that champions ex ante clarity and market standards must be approached with caution. An overly prescriptive approach to regulation could have unintended consequences that might stifle innovation and undermine the PSA's attempts to raise market standards. Firstly, whilst a prescriptive approach to regulation can establish certainty for compliant organisations, it can also make it easier for rogue operators to avoid compliance and identify loopholes in its compliance obligations. This problem will be exacerbated where the new compliance rules do not complement the due diligence and standards requirements imposed by mobile providers on its Level 1 and Level 2 providers.
21. There is also a risk that a prescriptive approach to regulation could stifle innovation. As the PSA observes, the phone-paid services market is characterised by highly dynamic competition between small and medium-sized businesses. Much of the innovation in this market has been driven by outcomes-based regulation. For example, the prevailing Code introduced 'single-click payments' regulation to the phone-paid services market. The market responded by maximising the ability of customers to pay by a single-click, including by clicking on images. Whilst highly innovative, this change resulted in a substantial increase in customer complaints stating that it was too easy to be charged.
22. In response to the increased customer complaints volumes for adult services and online competitions, the PSA introduced prescriptive new rules (covering only those areas). Rather than result in increasingly compliant behaviour, these more prescriptive rules led to operators switching to other service categories, such as games portals. Further Special Conditions were introduced to address the wider problems, but this has resulted in a variety of services moving onto alternative payment methods (PayPal) or avoiding mobile billing entirely⁸.
23. The above example demonstrates the need for a pragmatic balance between clear, easy-to-use regulation and an approach that delivers good outcomes for providers and consumers. In our view, this could be achieved by a

⁷ PSA – Developing the next PSA Code of Practice, para 200

⁸ This is particularly concerning given the PSA's observation that customers continue to find phone-paid services difficult to access or use, and that it remains expensive compared to alternatives (Figure 8). Prescriptive regulation could exacerbate these problems for consumers.

standards-based approach which consists of overarching outcomes that protect customers, but with more detail as to how this outcome should be achieved. We are willing and ready to work closely with the PSA and industry to develop this.

24. Finally, we urge the PSA to be consistent in its long-term regulatory approach. This shift to a prescriptive, rules-based approach represents a U-turn on its move to an outcomes-based approach in Code 12 (which in turn moved away from a prescriptive approach). Persistently switching between regulatory approaches is not sustainable and will ultimately undermine the PSA's attempts to raise market standards. Regulatory consistency is required.

Focusing on prevention rather than cure is the right approach but the PSA must recognise the obvious trade-offs

25. The PSA is concerned that it remains too easy for organisations to enter the market and cause customer harm. It has therefore proposed to undertake a variety of additional due diligence and risk assessment measures. The purpose of these enhanced checks is to ensure that those entering the market garner customer trust and operate compliantly⁹.
26. We agree, and we welcome the PSA's recognition that it can do more as a regulator to support the due diligence and security checks already undertaken by the mobile operators in the phone-paid services market. We already have an extensive due diligence and accreditation process, [redacted]. We already require our Level 1 and Level 2 partners to [redacted]¹⁰ before allowing them to engage with our customers and the market. Whilst effective in most instances, mobile operators' due diligence checks need to be supported by an equally robust regulatory framework. Like the PSA, our experience is that it remains far too easy for organisations to enter and re-enter the market with the intention of causing our customers harm.
27. At this stage, the PSA's proposals lack important detail as to how this "pre-operational" approach will work in practice. As it develops its plans, the PSA should consider how it will align and complement the due diligence already undertaken by mobile operators (and vice versa). For example, the PSA could carry out its own credit and director checks, including character and fitness tests, to ensure that directors and firm owners seeking to enter or re-enter the market have not historically broken the PSA's rules. Similarly, the PSA could obtain undertakings from the firm's director(s) that they have read, understood and intend to comply with the regulatory obligations set out in the Code and Special Conditions.

⁹ PSA – Developing the next PSA Code of Practice, para 218 - 224

¹⁰ This includes [redacted]

28. However, whilst the need for additional regulatory checks is patently clear, it is important that the PSA remain cognisant of the dynamic and innovative nature of the phone-paid services market. As the PSA recognises, the market is highly competitive, predominantly made up of innovative small and medium-sized businesses. With this market structure, there is a risk that overly complex and onerous pre-entry checks could be perceived, or act as a barrier to entry for smaller providers. For example, a smaller Level 2 provider might not be able to facilitate “regular compliance auditing” because they have insufficient staff or due to the requisite investment in new systems and processes. Similarly, a probationary period could act to disincentivise market entry as post-entry returns are not guaranteed until the probationary period is over.
29. The result could be that innovation is stifled, and that the market becomes more concentrated – only larger, blue-chip organisations are able to facilitate these compliance responsibilities. There is a risk that this market concentration could reduce price competition, resulting in phone-paid services becoming more expensive at a time when customers are already citing expense as a reason not to use phone-paid services¹¹.
30. We therefore remain cautiously supportive of the PSA’s proposals to introduce a “pre-operational” stage to its regulatory framework. Ahead of its consultation, the PSA must engage with industry – particularly the mobile providers – to ensure that any proposed “pre-operational” checks and authorisation complement any existing checks and supports the existing market structure.
31. One approach that the PSA might consider is a registration scheme that aligns with the registration schemes used by other regulators, for example the Gambling Commission. This will make registration with the PSA easier for larger organisations that are already registered with other regulators. It will also allow the PSA to take advantage of the insight and experiences of other regulators, possibly preventing firms with previous bad character in other markets from entering the phone-paid services market. A model of what this collaboration could look like can be seen in Ofcom, the Information Commissioners Office and the Competition and Markets Authority’s Cooperation Forum, announced on 1 July 2020¹².

Responsibility for compliance with the Code, Special Conditions and Guidance must sit with the Level 2 providers

¹¹ PSA – Developing the next PSA Code of Practice, para 162

¹² CMA, ICO and Ofcom launch the Digital Regulation Cooperation Forum – 1 July 2020, announcement found [here](#).

32. The PSA is seeking to identify ways in which its interventions, investigations and sanctions can be more effective in preventing consumer harm. We welcome this and agree that this review of the Code provides an opportune moment to ensure that the way in which the PSA's approach to sanctions is fit-for-purpose.
33. One proposal that the PSA submits is to hold non-compliant providers to account by extending liability for compliance to other providers in the value chain, including mobile providers¹³. Under Code 14 there is a clear division of responsibility for compliance with the Code, Special Conditions and Guidance. Level 2 providers are required to ensure content, promotions and operations remain compliant, whilst Level 1 and mobile providers are required to undertake due diligence and risk assessments. The PSA has not proposed to delineate compliance responsibilities in the same way for Code 15 – instead, looking at compliance responsibilities collectively.
34. We strongly oppose this approach. It is not clear how a collective responsibility for compliance will aid the PSA's investigation and enforcement action. Moreover, there is a risk that such an approach will result in unintended consequences, which ultimately undermine the PSA's objective of a more robust enforcement procedure:
1. The PSA's regulation must be proportionate and not unduly burdensome¹⁴. The PSA's proposal would make mobile providers responsible for content, promotion and operational compliance that it is neither capable nor equipped to have oversight. [§<]. Moreover, as a network operators we do not have a contractual relationship with Level 2 providers, many of which are based outside of the UK. Whilst, we already readily engage with our Level 1 providers to ensure that our due diligence and risk assessments remain compliant, it would not be proportionate (or indeed beneficial) for network operators to also maintain oversight of the hundreds of Level 2 providers within its portfolio.
 2. As we set out in our response to the PSA's consultation on the provision of refunds, requiring mobile operators to take greater responsibility for Level 1 and Level 2 provider compliance could have negative and unintended consequences. Rather than encouraging customer-facing providers to become more compliant, a collective approach to compliance will result in perverse incentives. Level 1 and Level 2 providers might seek to blame the network operators for a lack of compliance, relying on the fact that mobile operators are an easy target for regulatory fines. This will not incentivise more compliant behaviour.
 3. Extending compliance liability vicariously to mobile operators will result in us (and potentially other network operators) reconsidering our position in the phone-paid services market. As a network operator, [§<].

¹³ PSA – Developing the next PSA Code of Practice, para 218 - 237

¹⁴ Communications Act (2003), Section 6.1

35. When developing its Code, we strongly suggest that the PSA maintain the prevailing approach to compliance responsibility – Level 2 providers remain responsible for its content, promotions and operations, and MNOs and Level 1 providers focus on due diligence. In order to maintain the appropriate incentives and compliant behaviour, enforcement action must be targeted against those that break the PSA's rules, not distributed amongst the value chain.

The case has not yet been made for further reaching information gathering powers and greater fines

36. The PSA is also proposing to obtain further reaching and more flexible information gathering powers. As discussed in a meeting with the PSA on 23 June 2020, this could include a regulatory reporting structure that would require providers to submit data on a regular basis.
37. We agree that reliable and accurate data plays a vital role in the PSA's investigation and enforcement activities. However, in our experience the PSA does not use its existing information gathering powers to great effect. In 2019, we received just [X] information requests and [X] in 2020. Given these prevailing small volumes, it is not clear how further reaching and more flexible information gathering powers would assist the PSA in more robustly preventing consumer harm or intervene earlier. In our view, the PSA is yet to make the case for further information gathering powers. It has not set out in sufficient detail the extent of these information gathering powers, how they will be used and why they would be proportionate. In the absence of this explanation it is very difficult to support the suggestion that greater (and potentially more onerous) powers are required.
38. Furthermore, building the requisite systems and processes to regularly report information is expensive and complex. CPs have strategic and system development roadmaps (often planned 12-18 months in advance) and resource constraints that may make creation of new systems and processes difficult, particularly at short notice. We already have significantly contested roadmaps for our O2 and giffgaff brands¹⁵. Should the PSA require operators to put in place processes to regularly report on information there will inevitably be trade-offs with the implementation of other industry or regulatory initiatives.
39. Where the PSA intends to increase the number of information requests sent to industry it should clearly set this out, giving an indication as to the type information they are likely to require (individual transaction data or general market trends) and in what timeframes (will providers get two weeks or two months to respond to these requests). This information will allow industry to determine whether it can facilitate these additional requests for information.

¹⁵ We are already making significant systems and process changes in preparation for the implementation of the EECC end-user requirements, due to be published in September 2020.

40. The PSA is also proposing that it should retain greater flexibility in the amount it fines non-compliant operators¹⁶. We interpret “greater flexibility” to mean ‘larger value’ fines. In our view, this is not the correct approach and we will not support this prospect. The PSA has already acknowledged that fining non-compliant operators is not always effective, as many of those fined can evade the fine by liquidating their business and restarting operations under a new corporate identity. Recent examples include Webdata Ltd and IT Zone Ltd, who when investigated by the PSA in 2019 both liquidated and avoided paying any subsequent fine.
41. Rather than looking to impose larger fines, which will inevitably go unpaid, the PSA should focus on methods to *collect* fines more effectively. A more effective approach to collecting fines owed will deliver two key benefits:
1. Fines will now act as a more effective deterrent against non-compliant behaviour; and
 2. Compliant operators will no longer need to subsidise operators' non-compliance through increased levy fees. This is particularly relevant given the PSA has recently announced that it will be tripling the levy on operators this year. It should not be the case that compliant operators are punished as a result of the PSA's inability to collect fines.
42. We think that there are more simple and pragmatic sanction options available to the PSA. For example, as part of the registration scheme that we outlined above, the PSA could revoke the providers licence temporarily whilst the investigation progresses. Suspending the licence would prevent further consumer harm and act as an incentive for the firm(s) under investigation to comply with the investigation (a firm will want the investigation to conclude as quickly as possible to enable them to resume business activities). In our view, this would be a more effective deterrent, with fewer distorting market effects, than requiring providers to pay a deposit before entering the market.

Similarly, the PSA should consider collaborating with the relevant network provider on the investigation and what steps can be taken to protect customers in the short term. For example, the network provider could monitor the Level 2 provider in question to identify instances of consumer harm and provide information to the investigation in a timelier manner. This is particularly the case where information held by the network provider is not available or difficult to find when asked for retrospectively.

¹⁶ PSA – Developing the next PSA Code of Practice, para 237

Annex

<p>Q1 Do you agree with our proposed overall approach to the review? Please provide an explanation as to why you agree or disagree.</p> <p>Yes. We welcome the PSA's decision to engage with industry at an early stage before publication of its final consultation. The PSA must use information provided by industry (both formally and informally) to inform its final market assessment and proposals.</p>
<p>Q2 Is there anything else we should be considering?</p> <p>N/a</p>
<p>Q3 Do you agree with our assessment of the market? If not, why not? Is there anything else you think we need to consider?</p> <p>No. At present, the PSA's market assessment is incomplete and one-sided. As set out in our response above, the PSA must consider the views and evidence provided by industry to form a more comprehensive and informed market assessment.</p>
<p>Q4 Do you have any evidence of the market to share with us that you think would support our assessment?</p> <p>Yes. We have provided some evidence in our response above. We remain on hand to provide the PSA with any further evidence it might require.</p>
<p>Q5 Do you agree with our assessment, based on research, of consumer behaviours, experience and expectations?</p> <p>Yes.</p>
<p>Q6 Do you have any other evidence in this area that we need to consider?</p> <p>Yes. We have provided some evidence in our response above. We remain on hand to provide the PSA with any further evidence it might require.</p>
<p>Q7 Do you agree with our assessment of what the future holds? Please provide an explanation as to why you agree or disagree.</p> <p>No. At present, the PSA's market assessment is incomplete and one-sided. As set out in our response above, the PSA must consider the views and evidence provided by industry to form a more comprehensive and informed market assessment.</p>

<p>Q8 Are there are market developments which we have not factored into our assessment? How do you see these influencing the phone-paid services sector and associated regulatory challenges?</p>
<p>N/a</p>
<p>Q9 Do you agree with our proposed assessment framework? Please provide an explanation as to why you agree or disagree</p>
<p>Yes, we agree.</p>
<p>Q10 Are there are factors we have not taken account which we should?</p>
<p>N/a</p>
<p>Q11 Do you agree with our proposed initial thinking in terms of proposed changes to our regulatory strategy and approach? Please provide an explanation as to why you agree or disagree.</p>
<p>N/a</p>
<p>Q12 What are your views with regards to how we can best ensure that all firms operating in the phone-paid services sector will follow, and be held to, the same standard of professionalism?</p>
<p>As set out in our response above, we welcome the PSA's proposal to adopt a prevention rather than cure approach to regulation. However, this must be balanced with the need to support market growth. The PSA should engage with industry, and in particular the network operators, to ensure that the approach adopted is fit for purpose and aligns with existing industry due diligence.</p>
<p>Q13 What are your views with regards to developing appropriate 'Pre-purchase standards?</p>
<p>N/a</p>
<p>Q14 What are your views with regards to developing appropriate 'Purchase standards?</p>
<p>N/a</p>
<p>Q15 What are your views with regards to developing appropriate 'Post-purchase standards?</p>
<p>N/a</p>
<p>Q16 What are your views with regards to how we can make our investigations and enforcement procedures more effective?</p>
<p>As set out in our response, we do not agree that the PSA's proposals of distributing compliance responsibility, greater information gathering powers and the ability to impose larger fines will make the PSA's enforcement more effective. Instead, a more pragmatic approach is required – one that focuses on collecting fines more effectively, utilises existing information gathering powers and targets regulatory obligations in a way that incentivises good behaviour.</p>

<p>Q17 What are your views with regards to how we might achieve better outcomes for consumers and uphold the reputation of the market through more effective deterrents by considering the range of sanctions available to us?</p>
<p>N/a</p>
<p>Q18 What are your views on our existing funding model? Does it remain an effective model? Or do you think alternative funding models may provide a more sustainable approach going forward?</p>
<p>We remain concerned that the PSA's existing funding model is increasing the levy on providers in order to offset the PSA's failure to collect fines. The PSA has recently announced that it is significantly increasing the levy on providers, targeted mostly at the larger network providers. In our view, this approach to funding punishes compliant operators.</p>
<p>Q19 Do you consider the current categories of defined providers capture all relevant providers involved in the provision of phone-paid services and appropriately spreads regulatory responsibility throughout the value chain? Please provide an explanation as to why you agree or disagree.</p>
<p>Yes.</p>
<p>Q20 Do you think the current regulatory framework remains fit for purpose? Please provide an explanation as to why you agree or disagree.</p>
<p>N/a</p>
<p>Q21 Are there any areas of potential change proposed in this document which may have an impact which you believe should be considered? If so, please let us know, including any evidence you have as to the likely impact.</p>
<p>N/a</p>