

Business Plan & Budget 2015/16

A PhonepayPlus Consultation

A PUBLIC CONSULTATION

Issued by PhonepayPlus on 10 December 2014

The deadline for comment is 28 January 2015

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Executive Summary

In October, PhonepayPlus published a new Strategic Plan 2014-17 which set out a framework for delivering robust, fair and proportionate regulation that benefits both consumer protection and growth and innovation in the premium rate services (PRS) industry.

This Business Plan and Budget for 2015-16 sets out more detail on how PhonepayPlus will work within the framework of the Strategic Plan, to meet our obligation to ensure consumer protection in the market we regulate. It also sets out the resources that we require in 2015-16 to ensure a well regulated market for the benefit of consumers and industry alike.

PhonepayPlus is consulting on:

- a budget for 2015/16 which represents a cash freeze and a real terms decrease of 2.3% on the previous year;
- an overall proposed cost of PRS regulation estimated at £4,444,075 including VAT;
- taking into account RPI, an increase in the registration fee from £150 to £155 plus VAT and retaining the current fee exemption structure in support of market growth and innovation.

The adjusted levy is forecasted to fall into a broad range from approximately 0.45% to 0.65%.

PhonepayPlus' primary obligation is to ensure that we are funded sufficiently to meet our objectives and be an effective regulator. We take a proportionate approach to regulation, listening to and working in collaboration with industry and applying the rules reasonably in order to protect consumers and build confidence in the market. By working with industry we are able together to pre-empt many consumer issues before they become problems, and reduce the cost of regulation as a result.

The market has seen significant change over the past few years. Consumers have moved to smartphones and services which make increasing use of the mobile internet. Payment mechanisms have converged. PhonepayPlus too has been adapting to these changes, ensuring we apply the Code flexibility and accommodating new business models and practices whilst ensuring we deliver on our specific business plan objectives in support of our strategic goals.

However the market remains in a period of decline, 14.4% down year on year and further decline this year to date (4.5%). That said, longer term prospects remain more positive with tangible growth in operator billing and further potential in other sectors resulting from Ofcom's NGCS changes and emerging sectors such as voice shortcodes.

In recent years, PhonepayPlus' costs have grown, primarily relating to increasing volumes of contacts by consumers and activity to resolve complaints, up by 40% over a five year period. This is coupled with increased complexity in investigation and adjudication of cases driving increases in legal costs. Despite this PhonepayPlus has achieved a 25% real terms reduction in its budget since 2010.

The potential risks to consumers will continue to require management and PhonepayPlus must remain agile and adaptive to meet future consumer and market needs. This will be done in collaboration with industry to address risks before they can cause issues but also it must be recognised that many aspects of our regulatory approach and workloads are dependent on industry behaviour. We have a reliance on industry co-operation to drive up compliance and reduce complaints. The work for the year ahead will reflect this greater emphasis on partnership and collaboration, with industry, other regulators and stakeholders alongside the delivery of a number of major projects, primarily the implementation of the 13th Code.

The aim, to reduce our budget where it can be done without compromising our effectiveness or outcomes for consumers, continues and is reflected in this budget for 2015/16. Despite the

considerable increase in cost drivers, through efficiencies, appropriate savings in discretionary budgets and overheads and a greater emphasis on saving resources through partnership working with other organisations, PhonepayPlus is consulting on a budget for 2015/16 which represents a real terms decrease of 2.3% on the previous year. The overall proposed cost of PRS regulation is estimated at £4,444,075 including VAT. This is, broadly, a cash freeze compared with PhonepayPlus' budget of £4,444,645 for 2014/15. Included in this total is the budget for The Registration Scheme, which has increased slightly this year by £12,516. This reflects our plan to re-tender the hosting and operations of the Registration Scheme in order to realise a potential reduction in running costs for future years that newer 'cloud' databases technology is bringing. Taking into account RPI, we propose an increase in the registration fee from £150 to £155 plus VAT and retaining the current fee exemption structure in support of market growth and innovation.

The allocation of our resources has been adjusted on last year with more of our resources directed to handling contacts, informal enforcement and compliance through non enforcement approaches and smarter approaches to intelligence gathering and research.

Importantly in addition to the cost savings already realised we will deliver specific plans to tackle, in collaboration with industry, the key cost drivers of regulation in recognition that costs are also dependent on industry behaviour and co-operation to deliver further efficiencies in future years.

The levy rate is primarily affected by the expected size of the market and the fines and administrative charges collected in 2014/15 which reduce the amount needed to collect through the levy. This year has seen a reduction on the levels of fines invoiced and subsequently collected, as a result of an increased focus on proportionality and resolving complaints informally where appropriate to do so. This, combined with the continued market decline, means the levy rate is expected to increase. The adjusted levy is forecast to fall into a range from approximately 0.45% to 0.65%. This banding is deliberately broad at this stage in order to accommodate a number of uncertainties, including:

- Market performance across the remaining quarters of 2014/15;
- Updated estimate of market size in 2015/16 informed by market performance in 2014/15;
- Fine income levels over the remaining quarters of 2014/15.

In terms of the content of this consultation document:

Section One details PhonepayPlus' key aims and objectives following the publication of our new Three Year Strategic Plan 2014-17.

Section Two summarises key aspects of progress in 2014 on areas identified in the 2014/15 Business Plan and Budget.

Section Three considers the Market and other external conditions, noting that as the market has changed, incidences of consumer calls, enquiries and complaints have risen.

Section Four details PhonepayPlus' planned work organised around the objectives set out in the Strategic Plan 2014-17.

Section Five sets out the resources we will need to deliver these objectives and work plans.

Section Six covers the Registration Scheme developments and costs.

Section Seven considers the overall financial picture.

Our vision is that anyone can use premium rate services with absolute confidence in a healthy and innovative market. Within our remit and expertise, we seek a more consistent approach to regulating micropayments that are like PRS.

In this, PhonepayPlus has both consumers and providers' best interests in mind. It is good business in every sense to have a market in which consumers are free from harm and the industry is free to innovate.

Our Business Plan and Budget for 2015/16 is designed with this aim, and we hope that stakeholders will support it. We would be pleased to consider and respond to any comments made as part of the consultation process.

Feedback and comments

We are keen to gather feedback from all stakeholders on both the Business Plan priorities and the resource costs attached with delivering them. Details of how to respond are contained in the final section of the document. The closing date for responses is 28 January 2015. This period of time is such to allow the time necessary to consider fully all responses and to issue a notice to providers in changes to the levy and registration fees in good time for the start of the financial year on 1 April 2015.

Section 1: About PhonepayPlus

1.1 PhonepayPlus is the UK regulator for premium rate services (PRS). Our powers derive from a Code of Practice, which is approved by Ofcom under the Communications Act 2003. PRS are the goods and services that consumers can purchase by charging the cost to a phone bill, whether fixed line or mobile. In 2011, the current PhonepayPlus Code of Practice (12th edition) (the Code) was launched. This outcomes-based Code of Practice was designed to remain relevant, robust and effective during periods of rapid and disruptive technological, market and consumer behavioural change.

1.2 Our vision and values, updated in PhonepayPlus' new Strategic Plan 2014-17, underpin our approach to delivering robust, fair and proportionate regulation that benefits both consumer protection and growth and innovation in the PRS industry.

Our vision

Anyone can use premium rate services with absolute confidence in a healthy and innovative market. Within our remit and expertise, we seek a more consistent approach to regulating micropayments that are like PRS.

Our mission

Our mission is to achieve our vision and be a world-class regulator by:

- Putting the consumer at the heart of everything we do through providing effective regulation, information and assistance.
- Understanding the market in which we operate and how it is evolving, so that we can take early, proportionate and targeted action where needed to prevent consumer harm.
- Working with providers to build a healthy market with high standards of compliance.
- Having a Code of Practice that is cutting edge in protecting consumers while also supporting innovation in a fast-changing digital landscape.
- Applying our Code in a way that is impartial, fair, transparent, effective and proportionate.
- Working with Government, other regulators, industry, consumer bodies and international partners on matters within our remit and expertise.

Our core values

We continue to adhere to the principles of good regulatory practice. In addition, we have these core internal values and behaviours for carrying out our work:

Forward looking: We understand the market in which we operate and understand how technology, business models and consumer behaviour are changing and may change in future. We seek proactively and collaboratively to build compliance and to work with industry at an early stage to address emerging consumer issues rather than responding to problems after they have emerged.

Credible and trusted: We put consumers at the heart of our work. We act in a way that demonstrates that we are independent, impartial, trustworthy, transparent, accessible and consistent in all we do. Consumers can rely on us to deliver effective regulation and industry can rely on us to understand their business, to act proportionately and to explain and consult on what we do.

Reasonable and intelligent: We demonstrate sound judgment and act on the basis of evidence. We are principled and pragmatic towards providers and are aware of the commercial and technical environments under which industry operates.

Focused on delivery: We are effective and accountable. We project manage our work effectively to deliver results. We manage resources efficiently so as to ensure we continue to provide good value for money.

Prompt, open and transparent: We understand that both providers and consumers benefit from prompt action to resolve issues. We are transparent about our processes and the reasoning behind decisions.

Section 2: Highlights in 2014

2.1 During 2014 PhonepayPlus has sought to regulate proportionately and efficiently in accordance with the outcomes-based 12th Code of Practice in order to protect consumers and support innovation.

2.2 The market has continued to change with increasingly sophisticated digital goods and services delivered to connected devices, new payment mechanisms and changing consumer behaviour.

2.3 In turn PhonepayPlus is working to update its regulatory framework and its working practices. PhonepayPlus' new Three Year Strategic Plan and our work to develop a new 13th Code of Practice address the changes which the industry is experiencing, within the model of outcomes-based regulation which has proved successful through the current Code.

2.4 In our last Business Plan and Budget we set out four key themes for 2014/15. Set out below are the highlights of our work in 2014 to meet the objectives of those themes:

Theme One: Strengthening Compliance and Enforcement

2.5 PhonepayPlus is working to help the industry ensure that services are compliant with the Code of Practice, including through Due Diligence and Risk Assessment and Control (DDRAC). We have had ongoing work with Level 1 providers and Networks to look at and provide feedback on their DDRAC procedures. Initial Assessment investigations have been opened in DDRAC every time a Track 2 enforcement case is opened, which has encouraged the industry to make DDRAC an integral part of business practice.

2.6 PhonepayPlus, with the support of the PRS industry, is committed to ensuring that those who cause harm in the market pay for the additional regulatory cost they create. We have ensured non-paying organisations' relevant services are suspended and named individual/s or the relevant party is prohibited. The independent Code Compliance Panel has imposed fines of £1 million and barred 17 companies and individuals from the market this financial year to date.

2.7 PhonepayPlus has furthered our digital marketing guidance by publishing both a discussion paper inviting comment and an update paper on the use of affiliate marketing in premium rate services. In addition PhonepayPlus was pleased to see industry initiatives to build confidence in compliant affiliate marketing, including AIME's digital marketing guidance and Early Warning System.

2.8 PhonepayPlus has been working in collaboration with industry on strengthening compliance into service mechanics in the market and working collectively on policy application to service types to ensure effective consumer protection whilst understanding and accommodating industry requirements and challenges. This is in recognition that achieving compliance in the market is two way and that enforcement is not the only means to achieve positive outcomes.

2.9 PhonepayPlus has stepped up its engagement programme with industry providers, providing networks, L1s and L2s on a one to one basis with bespoke reporting and data exchange to increase awareness of contacts to PhonepayPlus and to share intelligence.

Theme Two: Improving consumers' experiences

2.10 In February 2014 PhonepayPlus published a major piece of research into the PRS consumer journey. Since then, we have made a number of changes to our processes to improve customer services. PhonepayPlus has introduced communications to providers and consumers at all stages of a complaint's journey through our investigation and enforcement processes. No complaint should go further than 6 weeks at any one time now without both parties being updated of the case

progression. We are also working with the PRS industry to help them implement changes to their customer care processes.

2.11 PhonepayPlus provides a number of consumer advice resources for both the general public and vulnerable consumers. Our PhoneBrain consumer education programme helps children and parents develop their confidence in using PRS and in understanding the costs involved. This year, we have also worked with other organisations including Childnet and *Which?* to extend the reach of our advice by syndicating content on their websites. Research is ongoing to develop our understanding of how vulnerable consumers get into detriment and we are working with stakeholders to mitigate these risks and build confidence in the market.

Theme Three: Future proof regulation

2.12 A major focus of 2014 has been the review of the current Code of Practice and our work to produce a 13th Code. This Code will be outcomes-based and keep our regulation up to date with changing market practices, developments in legislation, and other regulators' policy such as Ofcom's changes to non-geographic call services. The Code is planned to be implemented next year.

2.13 PhonepayPlus has applied regulation flexibly when appropriate to allow innovation whilst maintaining consumer protection. In May we launched a pilot programme to facilitate regulation of app stores with Google Play as the first participant, and following a successful pilot programme we have taken a more flexible approach in how the Code is applied to SMS charity donations.

2.14 We have invested in monitoring technology and techniques to increase our forensic capability as well as working with other agencies, industry and information security companies to ensure we are keeping pace with developments in security threats.

2.15 In response to proposed changes to UK and EU legislation, PhonepayPlus has engaged with the Department for Business, Innovation and Skills on the new Consumer Bill of Rights and its impact for PRS. We have also worked with AIME and the MBG to engage with the UK Treasury and the European Commission on the EU's next Payment Services Directive.

Theme Four: Enhancing regulatory efficiency and effectiveness

2.16 Over the past year we have developed our engagement with a number of organisations in order to gain new knowledge and contacts in areas that are shaping the PRS market, including The Financial Conduct Authority, The Competition and Markets Authority, The Information Commissioner's Office, the Advertising Standards Agency, the Gambling Commission, the Internet Watch Foundation, CEOP, Get Safe Online, *Which?*, Trading Standards, The Internet Advertising Bureau and internet security companies.

2.17 This year we have extended the time recording within the organisation so that we can understand where the time is being spent to ensure that we are efficient in our work and able to recoup all costs appropriately under the principle of polluter pays. We have also adopted 'cloud' technology for our phone system, which has lowered costs and improved capabilities. Looking to the future, process reviews and a systems-upgrade feasibility study have been conducted to identify the next changes required to maintain PhonepayPlus' effectiveness.

2.18 PhonepayPlus has also continued its programme of process review to ensure the most efficient and effective use of our resources, and that of industry providers in complying with our policies, and to ensure the quality of its inputs, outputs and overall outcomes.

Section 3: The Market and other external conditions

3.1 Overall the market is in a period of uncertainty with traditional PRS sectors in decline. The market has declined by 14.4% in 2013/14 compared to 2012/13 and by 25% over a five year period. Based on consumer spend it is now valued at approximately £600 million (excluding VAT).

3.2 Recently finalised Q2 figures show cumulative for the year a 4.5% decrease on last year suggesting a slowing of the decline potentially, although quarterly results are unpredictable and it remains too early to tell at this point. Cumulatively compared to last year, landline is down 26%, mobile up 2%, operator billing up 98%, DQ down 18% and 087 down 12%.

3.3 The decline in 087 sector revenues, after a long period of stability, can in part be attributed to the Consumer Contract Regulations introduced in June 2014 which prohibit the use of PRS (including 087) in the provision of customer care lines. We estimate that 25% of the 087 sector is comprised of such services and expect to see a corresponding decline in the market size.

3.4 However longer-term prospects remain more positive. We commissioned a study from Deloitte that estimates that operator billing has the potential to access a total market of over £500 million by 2019, and cumulatively for the year operator billing revenues increased by 98% as noted above (3.2).

3.5 We are seeing some appetite for the use of voice shortcodes. These shorter, more memorable numbers allow organisations to be clearer on the costs to consumers of using them. Although the market is still embryonic we will monitor its adoption during the coming year.

3.6 Ofcom's NGCS changes will begin to take effect in July 2015, when, amongst other things, the maximum rate of using 09 numbers will be increased. Correspondingly we have consulted on raising service caps. We believe that these factors may allow new service models to become viable for use as PRS. We anticipate that this may have the effect of arresting some of the decline of the landline market. We are continuing to seek information from networks and resellers involved in voice service provision as to the types and overall volume of services which are beginning to request higher price points as a result of Ofcom's changes.

3.7 We believe that there are many opportunities in a market that is prepared to invest and innovate along with regulation that is sufficiently flexible to facilitate growth.

3.8 However as consumers shift away from traditional PRS mechanisms and the market continues in a period of decline there is a danger that the incentives of maintaining consumer trust in order to build growth are being eroded. The market may be in decline but it is also generating more non-compliance. Contacts to PhonepayPlus are increasing (up 24%) and complaint volumes have increased by 40% in 2014/15 to date. Over a five year period complaints have increased by 40%.

3.9 The risks associated with some forms of affiliate marketing and malware must continue to be managed. And the minority of providers which resort to unscrupulous tactics in order to shore-up revenues and trading the reputation of the market as a whole for individual short-term profits must continue to be subject to robust enforcement.

3.10 The potential threat of the PRS market being abused by writers of malicious code, unlike in other territories, remains only a threat. So far, with only a few exceptions, the UK PRS industry has been successful in keeping these elements from accessing the UK market, which is a great credit to the efforts in Due Diligence and Risk Assessment and Control that Networks and Level 1 providers have undertaken.

3.11 The use by PRS providers of affiliate marketing networks continues to be a cost effective mechanism for marketing. However we continue to see some affiliate networks generating traffic by

creating misleading journeys. We will continue to work with industry so that the market can use these services in a way that contributes to the health of the market.

3.12 Overall, due to the uncertainty, pace of convergence and the rapid changes to technology and consumer behaviour, PhonepayPlus must remain agile and adaptive enough to meet future consumer and market needs. Many aspects of our regulatory approach and workloads are dependent on industry behaviour and we are reliant on industry co-operation if we are to drive up compliance in the market and reduce complaints. We believe the best way of doing this is to work collaboratively and in partnership with the PRS industry to build compliance into the market and to identify and resolve any emerging issues.

Q1. What information or evidence do you have about market trends and about the overall size of the phone-paid services market in 2015/16?

Q2. What information or evidence do you have about any specific segments or content areas and their potential for real growth or decline over 2015/16?

Q3. What information or evidence do you have as to the types and overall volume of services which are likely to operate at higher price points and the most popular higher price points so far requested as a result of Ofcom's NGCS review?

Q4. How do you see the phone-paid services market developing in 2015/16?

Section 4: The year ahead

4.1 Technological and market change has created both challenges and opportunities for providers in recent years. As noted in the previous section, the market has declined by 25% over a five year period. In line with this, since 2009/10 PhonepayPlus has reduced its budget by 25% in real terms.

4.2 Consumer enquiries and complaints to PhonepayPlus have risen. Complaints are 40% up over the same time period. We have maintained effective consumer support through innovating in our working practices and efficiency savings, but if enquiries and complaints remain at their current volume and complexity future savings in this area will be challenging without industry behavioural change and co-operation.

4.3 PhonepayPlus' new Strategic Plan for 2014/17 recognises the changes in the market and focuses on five objectives, around which this Business Plan's priorities are organised:

1. To continue to drive up compliance levels and trust in the market
2. To identify and prevent emerging risks to consumers
3. To help consumers to use premium rate services with confidence
4. To ensure that regulatory frameworks keep pace with market changes
5. To deliver effective and efficient regulation

4.4 These objectives are mutually reinforcing, for example due diligence work both drives up compliance levels and helps prevent risks to consumers. If successful, it can reduce the costs of regulation and enforcement action, in turn supporting our objective to deliver effective and efficient regulation.

4.5 Additionally, in light of market changes PhonepayPlus will continue to look for cost reductions as part of our work towards the objective of efficient regulation that supports innovation.

Objective 1: To continue to drive up compliance levels and trust in the market

4.6 PhonepayPlus recognises its role in supporting a healthy market and protecting consumers, and we work with industry to this end. We give PRS providers information and advice on complying with the Code of Practice and where problems arise we take proportionate and reasonable action to set things straight.

Updating the Code of Practice and Guidance to ensure they are effective and future-proof

4.7 The current Code of Practice's outcomes-based approach allows PhonepayPlus to operate flexibly and respond to developments in what is now a fast-changing market. In 2015/16 we will launch a new 13th Code which responds to the challenges of UK/EU legislation and aligns with other regulators' work, including Ofcom's Non-Geographic Call Services review. We will take feedback from stakeholder groups on the likely impacts of our regulation and use this to ensure regulation remains proportionate.

Expected outcome: following extensive consultation, implementation of a revised Ofcom-approved Code and supporting Guidance which continues to enjoy wide industry and stakeholder support and understanding. Regulation which is transparent, independent, fair, proportionate, consistent and targeted.

Engaging and sharing information with industry and the wider value chain

4.8 Regular engagement and information sharing assists PRS providers in due diligence and risk assessment and control and can help prevent many instances of consumer harm, reducing the

need for action by PhonepayPlus. In 2015/16 we will expand our programme of one-to-one meetings and engagement with Network Operators, Level 1 and Level 2 providers to assist them in identifying emerging issues, trends and concerns so that appropriate early intervention can be taken.

Expected outcome: improved use of Due Diligence Risk Assessment and Control in the industry, overall levels of compliance in the market will increase.

Effective and proportionate use of enforcement powers

4.9 The majority of consumer complaints that PhonepayPlus receives relate to a minority of providers. PRS providers who comply with the Code should not have to pay the bill for non-compliant providers. In 2015/16 we will undertake a number of activities to ensure polluters pay and suspend the services of organisations that have not paid their fines:

- Strengthening the polluter pays principle in the new Code of Practice;
- An end-to-end review of processes to assess complaints more effectively, enforce more proportionately and to investigate and resolve cases efficiently;
- Working with Companies House to ensure polluters do not try to avoid investigations by dissolving their company.

Expected outcome: providers who cause harm in the market pay for the direct and indirect costs of the harm they produce, overall levels of serial offenders in the market will decline and collection rates of fines and related costs will increase.

Objective 2: To identify and prevent emerging risks to consumers

4.10 While technological advance benefits consumers, we are mindful of the pace of change in digital markets and of the risk that comes with any new development.

Using research and market intelligence to identify emerging issues in the market

4.11 PhonepayPlus will continue to develop our research and intelligence capabilities, to keep pace with technological change and new risks, and to work with the industry and partners to address the risks posed by issues such as mobile malware.

Expected outcome: threats from emerging risks such as mobile malware are identified and contained quickly and do not become the source of widespread concern for consumers.

Working in partnership to add value

4.12 We will put a greater emphasis on strategic partnerships and sustainable joint-working with other bodies in recognition of the convergence in digital payments markets and of the increased effectiveness and potential resource savings it makes possible.

- Investigating opportunities for collaborative work on research and market intelligence;
- Working with consumer bodies and others to more effectively 'signpost' consumers to our advice and the correct way to raise an enquiry or an issue with the value-chain;
- Joint working with other regulators and allowing them to take the lead when they are best placed to do so.

Expected outcome: PhonepayPlus' remit as the regulator of phone paid services, including operator billing, is understood and recognised by other agencies and enforcement bodies. We engage effectively with relevant bodies and remain responsive to their feedback.

4.13 We also will review industry engagement generally to ensure we have the best forums and structures in place to support this. This mix would will take in to account how we deal with market

crisis issues, how we are engaging on the future of the changing industry and how we ensure that both the current and new market entrants are properly engaged.

Expected outcome: PhonepayPlus and industry have effective channels of engagement enabling meaningful collaboration and the identification and addressing of risks before they can cause harm to the market.

Objective 3: To help consumers use premium rate services with confidence

4.14 This objective relates to both consumers' overall experience of using PRS and how PhonepayPlus deals with its own customers.

Helping consumers to avoid potential risks and to obtain redress when harm is suffered

4.15 In 2013/14, PhonepayPlus received 33,301 contacts from consumers. Comparing the last twelve months to the previous, contacts are up by 24%. In recent years both the complexity and the volume of complaints has increased (up by 40% over a five year period). PhonepayPlus will continue to engage with the industry on how to improve consumers' experiences, through implementation of solutions and improvements identified through the consumer journey workshops, and will continue to review its consumer communication processes on efficiency grounds and in response to developments such as Ofcom's NGCS changes. Such improvements, in addition to the benefits to consumer confidence and redress, have the potential to make a tangible impact on costs. We estimate that a 20% reduction in complaint case volumes over the medium term could lead to investigations and legal savings, primarily in direct costs, within the region of £100,000 per year.

Expected outcome: the parties in the value chain that can influence the consumer journey take action to improve customer service, consumers understand the transactions they make and can obtain information and appropriate redress when required.

Protecting vulnerable consumers

4.16 In the first six months of this year, we estimate that 10% of complaints are from groups who may be judged in one way or another to be vulnerable. In 2015/16 we will undertake a number of activities to protect vulnerable consumers including:

- Work to analyse and assess potential areas of consumer vulnerability;
- Updates to the consumer literacy programme in light of market developments;
- Increased syndication of PhonepayPlus' consumer advice through other organisations to maximise reach and efficiency.

Expected outcome: a clear understanding of consumer vulnerability in this changing digital market, relevant and clear consumer advice, and a decline in the number of complaints about services where consumers may be vulnerable.

Objective 4: To ensure that regulatory frameworks keep pace with market changes

4.17 This objective recognises the innovations and changes that have occurred in PRS and digital content markets and their implications for PhonepayPlus as a regulator. As premium rate is offered as a payment option alongside other micropayments for the same digital services, consistency in regulation for providers and consistency in protection for consumers is vital.

4.18 In 2015/16 we will undertake a number of activities to identify address and changes in the market in digital content and services and ensure that regulation remains relevant. These areas include:

- Operator billing and the completion of our pilot project to regulate phone payment in app stores;

- Quasi-physical goods and services and their effect on consumer behaviour;
- Providing flexibility in the 13th Code to enable new entrants and business models in the market, and continuing to use the provisions in the current Code to use this flexibility, as we did with our exemption for SMS charity donations earlier in 2014;
- Engagement with industry and government around legislative or regulatory issues that affect the market for digital goods and services, such as the Payment Services Directive;
- Further engagement with other regulators and organisations, building on our work in recent years to form new partnerships with regulators and bodies relevant to areas that are shaping the PRS market and the wider digital content market.

Expected outcome: possible market developments are identified and research provides the basis for agreement with other stakeholders, other regulators, and government on suitable action in response.

Objective 5: To deliver effective and efficient regulation

Reducing costs whilst maintaining effective regulation

4.19 In recent years PhonepayPlus' cost pressures have been increasing. As detailed in Section Three above and in Section Five which follows, complaints and enquiries from consumers have risen; underlying costs such as our building rent are rising; and there have been increasing costs from legal challenges.

4.20 PhonepayPlus will deliver on specific plans in collaboration with industry on tackling the cost drivers of regulation around:

- Improving market compliance and DDRAC (see Objective 1 above);
- Improving the consumer journey (see Objective 3 above);
- A review to identify drivers of PhonepayPlus' legal costs and any changes which could be made to reduce them.

4.21 Additionally, we will deliver on specific plans in order to seek to reduce costs through:

- Appropriate savings in discretionary budgets;
- Productivity gains;
- Savings in overheads, including reviews of premises and system infrastructure.

Expected outcome: action identified to tackle PhonepayPlus' key cost drivers and to reduce our budget where it can be done without compromising our effectiveness or outcomes for consumers.

Continually improving our business

4.22 In 2015/16 we will undertake a number of activities to improve our business, including:

- End-to-end process and data reviews to support efficient working and good customer service;
- Further improvements to time recording and capturing costs to ensure we are efficient in our work and we are able to allocate all costs appropriately under the principle of polluter pays;
- Conducting a systems upgrade tender with the aim of providing greater resilience and a lower range of support costs;
- Continuing to build and enhance our staff and management capability to ensure we get the best support and delivery from our people.

Expected outcome: PhonepayPlus continues its programme of efficiency savings whilst ensuring that it remains effective as a regulator and provides excellence in customer service.

Q5. What comments do you have on the priorities for 2015/16? Are there other projects or issues that you think PhonepayPlus should consider for the coming year?

Section 5: Resources and activities

Resources

5.1 We have cut our core budget significantly in recent years, by 25% in real terms since 2010, meeting the commitment of the Strategic Plan 2011/14 and we continually strive for best value. However, a number of factors have driven PhonepayPlus' costs in recent years. Some of these factors are dependent on industry behaviour and we are therefore also reliant on industry cooperation if we are to reduce costs. These cost drivers include:

- The volume and complexity of consumer calls, enquiries and complaints that we receive continues to grow, complaints up by 40% over a five year period, prompting increases in staff costs;
- An increase in legal costs, reflecting the increasing litigation arising from some providers and the increasing number of overseas-based providers, which complicates investigation and enforcement work;
- The five year lease for PhonepayPlus' offices is due for renewal in November 2015 and the rental market has become more expensive since 2010.

5.2 By way of comparison, PhonepayPlus estimates that a 20% reduction in complaint case volumes over the medium term could lead to investigations and legal savings, primarily in direct costs, within the region of £100,000 per year.

5.3 PhonepayPlus is conscious of the challenges facing providers in light of market changes and the current conditions described in Section Three and we propose a number of actions in 2015/16 to tackle our cost drivers as detailed in Section Four. Our obligation as a regulator is to ensure consumer protection in the market we regulate and to ensure that we have sufficient resources to meet our objectives; however, we also have a duty to use resources efficiently and to be mindful of the impact of the cost of regulation on the industry. To that end we aspire to reduce our budget where possible. Despite the considerable increase in cost drivers, through efficiencies and appropriate savings across the organisation, PhonepayPlus is consulting on a budget which represents a real terms decrease of 2.3% on the previous year.

5.4 The overall proposed cost of PRS regulation for 2015/16 is estimated to be £4,444,075 – a real terms cut of 2.3% taking account of the impact of inflation (RPI of 2.3% as at October 2014) and a freeze in cash terms. Our core levy-funded budget will decrease by 0.3% in cash terms and decrease 2.6% in real terms allowing for inflation to a proposed budget for 2015/16 of £4,075,087 with reductions across a number of areas. The Registration Scheme budget has increased to £368,988 (an increase of £12,516 or 3.5%) due to the initial cost of moving the Registration Scheme's database to 'cloud' technology, which will reduce the scheme's running costs over the life of the contract. This Registration Scheme change is outlined in more detail below, in Section 6.4.

5.5 As can be seen from Figure 1 (below, p.17) our staff remain the largest portion of the core Levy Budget. Our staff's work has allowed us to maintain a high level of service throughout a period of significant increases in the volume of complaints (and to deliver regulation effectively where cases under investigation and adjudication of are of increasing complexity).

5.6 We propose to reduce the Staff budget by 0.9% in cash terms next year. This is a real terms reduction of 3.2% in light of RPI. We need to maintain frontline and legal resources to meet ongoing demands; however we have been able to slightly reduce the headcount for the Executive.

5.7 The rising cost of premises and other relevant overheads, including utilities have been largely absorbed for a number of years. PhonepayPlus' office lease is approaching the end of its five year term and is due for renewal in November 2015. Property rental prices have risen significantly since 2010, when PhonepayPlus secured very favourable terms. We have begun a review of rental

and associated costs to understand best options to tackle this cost driver and to ensure the most cost efficient position with regard to location and premises. We have made some assumptions on these figures as the review is in its initial stages and so we have budgeted for an increase of 22.7% in premises costs for 2015/16. We have started the review at this time as it is the point at which we can best predict and understand the likely market options that will be available when the current lease ends next year.

5.8 Legal fees have increased by 35.3% compared to last year's budget. This is in line with actual spend on legal costs in 2014/15, which has been significantly higher than budgeted. The amount budgeted for legal costs in 2015/16 is based on actual costs in 2014/15 and our best forecast of required spend in the next financial year. As described above in section 4.21, we plan a review of the drivers of PhonepayPlus' legal costs and any changes that could be made to reduce them in future years.

5.9 PhonepayPlus is proposing savings in a number of areas:

- We have rationalised our research and policy teams to deliver these functions more efficiently and more effectively through other means, whilst maintaining products such as the annual premium rate services market review. This 26.7% saving is reflected in the table below at 'Research';
- In the area of 'external expertise', which includes PhonepayPlus' use of consultants and other external advice, we propose a saving of 27.6%;
- Overheads costs are projected to fall by 8.3%.

PhonepayPlus Expense Budget 2015/16						
	Budget	Budget	Budget			
	2015/16	2014/15	(Inc) / Dec	%		
	incl VAT	incl VAT	incl VAT		Change	
	£	£	£			
Staff	2,539,527	2,563,700	24,173	0.9%		
Communications	110,207	114,887	4,680	4.1%		
External expertise	117,852	162,712	44,860	27.6%		
Legal	171,396	126,708	(44,688)	(35.3%)		
Research	132,000	180,000	48,000	26.7%		
External audit & outsourced services	18,702	17,811	(892)	(5.0%)		
Overheads	304,860	332,342	27,482	8.3%		
Premises	457,382	372,762	(84,620)	(22.7%)		
Publications	22,809	18,960	(3,850)	(20.3%)		
Telecoms	72,027	65,664	(6,363)	(9.7%)		
Website	30,436	36,316	5,880	16.2%		
Depreciation	97,889	96,313	(1,575)	(1.6%)		
Total budget funded by Levy	4,075,087	4,088,173	13,086	0.3%		
Registration Scheme	368,988	356,472	(12,516)	(3.5%)		
TOTAL	4,444,075	4,444,645	570	0.0%		

Figure 1 (For breakdown of Registration Scheme Budget see Figure 3)

Activities

5.10 PhonepayPlus considers its cost drivers through an activity-based model, as well as producing a budget based on the accounting-based expenses model that is detailed in preceding paragraphs.

5.11 The activity-based model below aligns costs against the core functions that PhonepayPlus delivers for consumers and the industry, to make clear where resources are being allocated year-on-year.

5.12 The allocation produced in Figure 2 (below, p.19) has some revisions in allocation of resources to previous years. The main changes are below:

- *Consumer support: this activity includes consumer advice, the PhonepayPlus contact centre, and other activity on behalf of consumers*

The higher percentage of resources allocated to consumer support, up by 9.4% from £768,812 £841,382 incl. VAT, reflects increases in consumer support costs and in communications time being spent on this area in line with rises in consumer complaint and contact volumes increasing in recent years;

- *Enforcement – Complaint Resolution: this activity covers work with providers to resolve consumer complaints*

The balance of activities within enforcement, with funding for complaint resolution increased by 33.5% from £292,397 to £390,477 due to an increased focus on resolving complaints and supporting consumers proportionately using our informal enforcement routes and other non-enforcement approaches. These changes propose to increase funding to complaint resolution and consumer support teams and allocate fewer resources within this activity to legal and formal investigatory costs.

- *Enforcement – Investigations: this activity relates to formal investigations and the work of the Code Compliance panel*

Fewer resources have been allocated to investigations, down by 10.6% from £1,494,385 to £1,336,274. This reflects an increased focus in other activity areas on complaint resolution and communications that support consumer advice. Within the activity area of Enforcement – Investigations, provision has been made for increased legal costs in light of recent trends.

- *Industry Support: this includes advice for industry and events such as PhonepayPlus' industry forums*

There is a small change in the split of activities allocated to industry support, reflecting the savings made in PhonepayPlus' research commissioning described at section 5.9 above. It is reduced by 4.3% from £935,949 to £895,636.

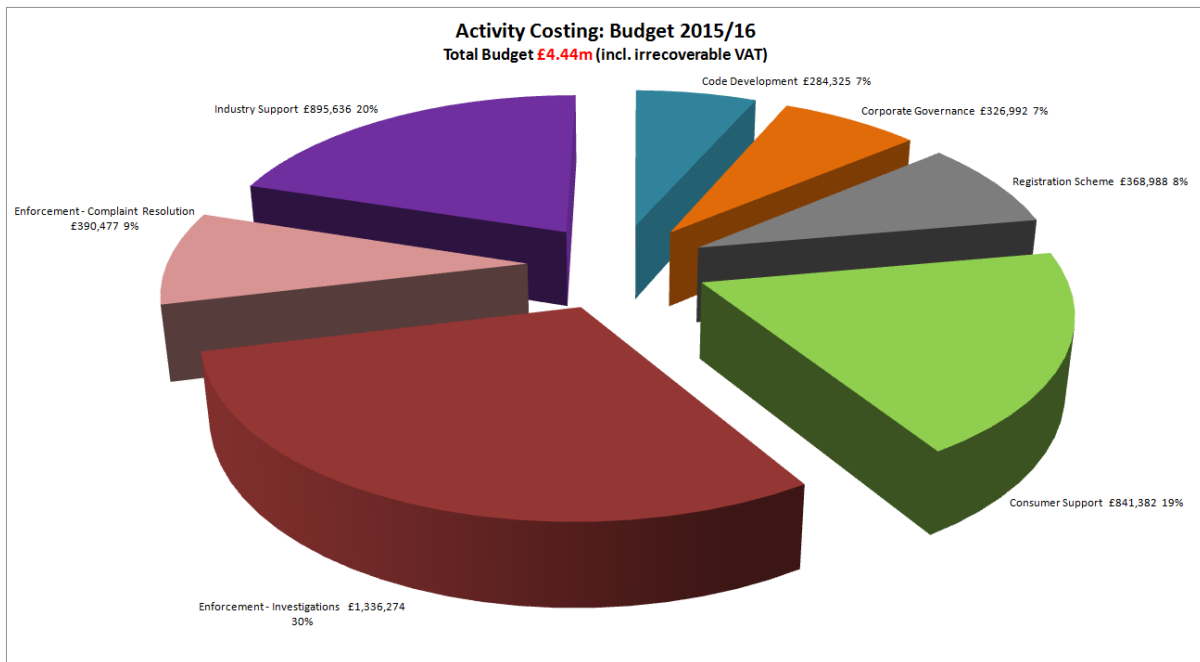


Figure 2

Q6. Do you support our proposed resource allocation for 2015/16, having regard to the activities and strategy that drives the changes? If not, please explain why.

Section 6: The Registration Scheme

6.1 In April 2011 we introduced a mandatory Registration Scheme for all PRS providers. The Registration Scheme provides a due diligence system which allows Level 1s and Networks undertake initial checks on those they are intending contracting with. The Scheme also allows organisations to register the service numbers that appear on consumers bills via the Number Checker.

6.2 In line with our outcomes based approach to regulation this year we introduced a 12 month pilot scheme which allows app stores to apply for an exemption from the Registration Scheme on behalf of the developers who sell apps in their store via operator billing. This exemption is granted in cases where app stores operate sufficient controls of their own and it does not exempt developers from the Code of Practice more generally. Google Play is the first participant in this pilot. This pilot demonstrates the flexibility of the Code specifically in areas of registration as well as more broadly.

6.3 Registration numbers are 9% below their forecasted level. Current registration numbers are 2,693 compared with 2,973 at this time last year.

6.4 This year we plan to re-tender the hosting and operation of the Registration Scheme in order to realise a potential reduction in running costs that newer 'cloud' database technology is bringing. We anticipate reducing operating costs and minimising the requirement to upgrade software every three to five years, which will make the costs of operating the Registration Scheme viable ongoing. Any reduction realised will take effect from the 2016/17 budget.

6.5 As a result of the planned upgrade work above to realise future savings, the Registration Scheme budget shows an increase of £12,516 or 3.5% for next year.

6.6 In light of RPI we propose an increase in the registration fee from £150 to £155 (plus VAT). We have considered the option of removing existing exemptions and charging a universal fee to all providers however we have decided against this based on our assessment of its potentially negative effect on market growth and innovation.

	Budget		Budget		Budget Variance	%
	2015/16		2014/15		(Inc) / Dec	Change
	£		£		£	
Staff	100,070		97,103		(2,967)	(3.1%)
External expertise	10,000		10,000		0	0.0%
Overheads	95,851		101,704		5,853	5.8%
Premises	13,319		11,451		(1,868)	(16.3%)
Website	13,567		23,560		9,993	42.4%
Depreciation	133,837		110,639		(23,198)	(21.0%)
Total excluding VAT	366,644		354,457		(12,187)	(3.4%)
Cross-charge VAT impact on Registration	2,344		2,015		(329)	(16.3%)
Total incl irrecoverable VAT impact	368,988		356,472		(12,516)	(3.5%)

Figure 3

Q7. Do you agree with our approach to the charging model, during 2015/16? If not, please explain why.

Section 7: The financial picture

The levy-setting process

7.1 While the Registration Scheme is funded by an annual fee (as described in Section 6), the core budget is primarily funded by a levy on providers – deducted at source by Network operators. Funds are withheld at Network operator level and paid to us by them on their clients' behalf. At the end of each year these funds are reviewed against actual market activity levels and there is a reconciliation, with any additional monies owed to us paid over, and/or the refund of any excess payments that Network operators have made on account.

7.2 The levy rate is affected by a number of issues:

- The cost of regulation – the budget amount that the levy and other sources of funds have to cover;
- The expected size of the market – the amount of expected outpayments on which the levy would be payable and any predictions of growth based on new transactions and service types. The market size is also affected by our remit, as defined by Ofcom. If this is narrowed, then the base cost of regulation for the remaining providers will increase accordingly;
- Fines and administrative charges collected in 2014/15 – these monies are always returned to funders insofar as they go towards reducing the cost of the future year's regulation and, therefore, reduce the amount we need to collect through the levy. The amount of fines and charges issued varies from year to year, as a result it cannot and should not be considered a core part of PhonepayPlus' budget
- Market developments in the preceding year – if the PRS market exceeds expectations in 2014/15, the additional levy collected would go towards covering the costs of 2015/16. On the other hand, a fall in the market in 2014/15 would involve the repayment of excess levy collected from Network operators and this deficit would need to be made good in the following year;
- Any need to make changes to our contingency reserves – these exist to deal with any new, exceptional 'spike' problems that require extra staff and legal or other resources, and to deal with the possibility of winding-up the organisation at some future point; and
- The overall impact of UK taxation policy as it affects a non-profit making company such as PhonepayPlus.

7.3 The adjusted levy is forecast to fall into a range from approximately 0.45% to 0.65%. This banding is deliberately broad at this stage and is our best estimate accommodating a number of uncertainties that will be clearer when Q3 figures are available, including:

- Market performance across the remaining quarters of 2014/15;
- Updated estimate of market size in 2015/16 informed by market performance in 2014/15;
- Fine income levels over the remaining quarters of 2014/15.

..

7.4 The potential increase in the levy (0.45% this current year) reflects the decline in the market, which has a considerable impact on levy calculations, in conjunction with reduced levels of fines invoiced this year as a result of PhonepayPlus having placed a greater focus on due diligence and complaint resolution rather than on enforcement action. Fines issued this financial year are projected to be 60% down on invoicing levels last year with the fine collection level (the amount available to offset the cost of the levy) correspondingly reduced and forecast to total approximately £0.85 m compared to £2m last year. Fine collection rates remain at consistent levels in recent years at around 60%.

7.5 Notwithstanding that the levy rate is primarily driven by market size and fine and administrative charges collected, as detailed in 7.2 above, PhonepayPlus is proposing a real-terms cut in its budget for 2015/16 and action to tackle our main cost-drivers. This is in recognition of the

need to be mindful of the costs of regulation whilst ensuring we are sufficiently funded to meet our objectives and be an effective regulator. This cut is significant given it builds on cost efficiencies in previous years resulting in a reduction of our core budget by 25% since 2010 whilst maintaining effective consumer support through efficiencies and innovative working practices. PhonepayPlus is already a lean organisation and there is limited potential for further substantial savings without the industry co-operation to compliance noted earlier in the document.

7.6 Figure 4 below, which plots the PRS market size by outpayments against the Adjusted and Unadjusted levy over the previous six years discounted, demonstrates the impact of market size on the levy.

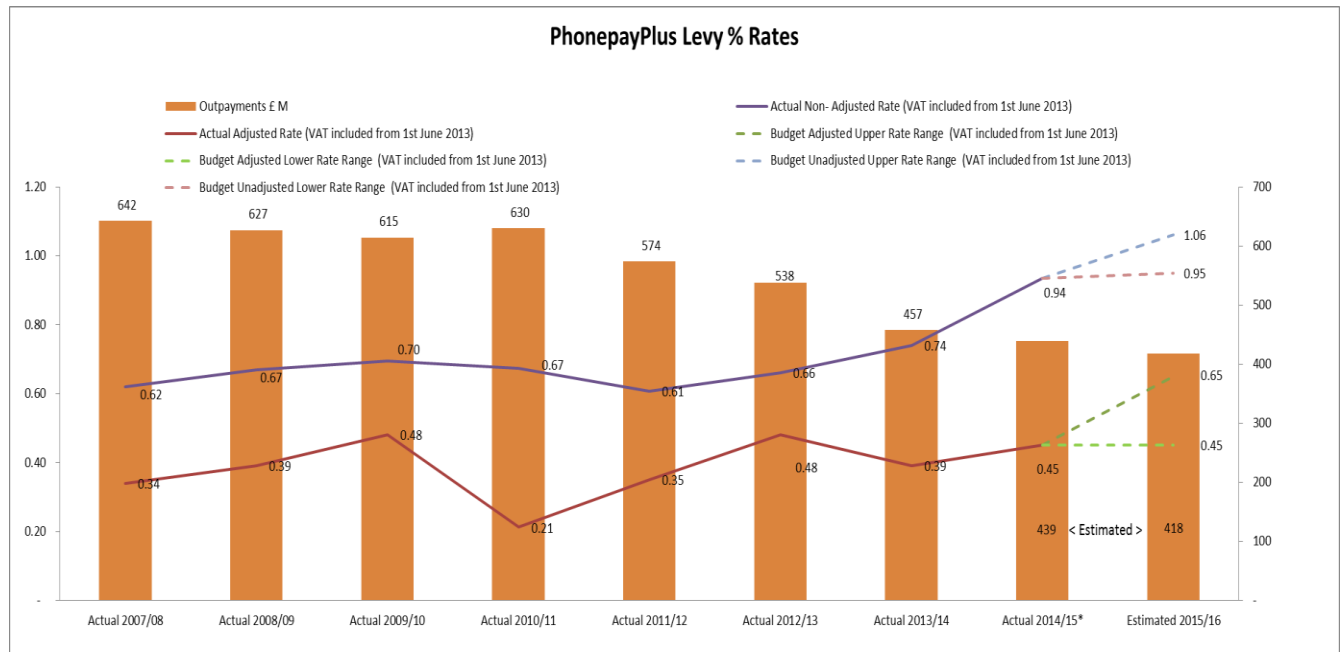


Figure 4

Section 8: Responding to the consultation

Summary of questions

Q1. What information or evidence do you have about market trends and about the overall size of the phone-paid services market in 2015/16?

Q2. What information or evidence do you have about any specific segments or content areas and their potential for real growth or decline over 2015/16?

Q3. What information or evidence do you have as to the types and overall volume of services which are likely to operate at higher price points and the most popular higher price points so far requested as a result of Ofcom's NGCS review?

Q4. How do you see the phone-paid services market developing in 2015/16?

Q5. What comments do you have on the priorities for 2015/16? Are there other projects or issues that you think PhonepayPlus should consider for the coming year?

Q6. Do you support our proposed resource allocation for 2015/16, having regard to the activities and strategy that drives the changes? If not, please explain why.

Q7. Do you agree with our approach to the charging model, during 2015/16? If not, please explain why.

We are seeking the views of all stakeholders on the proposals and questions contained in this paper by no later than 28 January 2014 (seven weeks from the date of issue of this document).

Where possible, comments should be submitted in writing and sent by email to:

consultations@phonepayplus.org.uk

Copies may also be sent by mail to:

Peter Morton
Head of Communications
PhonepayPlus
1st Floor, Clove Building
4 Maguire Street
London SE1 2NQ
Tel: 020 7940 7423

If you have any queries about this consultation please telephone or email Peter Morton using the above contact details.

Confidentiality

We plan to publish the outcome of this consultation and to make available all responses received. If you want all, or part, of your submission to remain confidential, you must make a specific request for this along with your reasons for making the request.

Annex A: Three-Year Strategic Plan (2014/17) Objectives

Objective 1:

To continue to drive up compliance levels and trust in the market

- Updating our Code of Practice and Guidance to ensure they remain effective and future-proof.
- Engaging actively, and sharing information, with industry and other stakeholders throughout the value chain.
- Making effective and proportionate use of enforcement powers under our Code of Practice.

Objective 2:

To identify and prevent emerging risks to consumers

- Using research and market intelligence to identify emerging issues in the market.
- Developing our market expertise and partnerships with other regulators, consumer bodies, trade bodies and organisations such as internet security companies.
- In collaboration with phone providers and others, taking early action through enforcement, policy development and other tools to prevent emerging issues from becoming active problems.

Objective 3:

To help consumers to use premium rate services with confidence

- Helping consumers to obtain redress where they have suffered harm.
- Putting in place additional protections for vulnerable consumers, such as children.
- In collaboration with partners, providing information and support to consumers about potential risks and how to avoid them.

Objective 4:

To ensure that regulatory frameworks keep pace with market changes

- Developing our knowledge of how the market in digital content and services is changing and of the implications of this for consumers, providers and regulation.
- Working with industry, other regulators, consumer bodies and government to build a consensus on the best and most effective responses to these changes.

Objective 5:

To deliver effective and efficient regulation

- Ensuring that our regulation continues to deliver the outcomes for consumers and the industry set out in our Code of Practice.
- Ensuring that we use resources efficiently and provide good value for money.