Business Plan & Budget 2013/14

A PhonepayPlus Consultation

A PUBLIC CONSULTATION

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The deadline for comment is 17 January 2013

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Executive Summary

2012 has been the first full year of operating under our new regulatory framework, which is underpinned by an outcomes-based Code of Practice and a mandatory Registration Scheme. These were designed to support the new responsibilities on Networks and providers to undertake effective due diligence and risk assessment before they contract with clients as well as on-going monitoring and assessment of risk once services go live. This shift of regulatory emphasis, we firmly believe, is right and in the longer term interests of consumers and industry alike. But the transition was never going to be straight-forward. This Business Plan provides a basis for explaining where we are in that journey of change, the issues that we will have to deal with to support the market in this process of transition and the proposed actions we expect to take going into 2013/14 in order to address them.

Section 2 of this document describes the highlights from the last 12 months, both in terms of the actions PhonepayPlus has delivered within the context of our Three-Year Strategic Plan (2011/14) as well as the context of a significant increase in complaints – the start of which pre-dates the launch of the new Code.

Section 3 provides a broad overview of the premium rate market as our research and intelligence portrays it. We see opportunities for growth arising from the disruptive change taking place in the technological landscape, alongside a trajectory of decline for some more traditional services that increasingly have to compete for attention from services delivered over the internet.

Sections 4 and 5 detail the core issues and problems that PhonepayPlus will be addressing as priorities in 2013/14 to ensure that consumers can increase their use of premium rate services (PRS) with growing trust and confidence against a backdrop of improving market compliance. These sections then go onto identify the three high level themes for next year followed by action plans designed to address the factors we see as essential to building a prosperous and trusted market.

Sections 6, 7 and 8 set out the budgetary implications for delivering the Business Plan. Section 6 focuses on the core levy budget costs. Section 7 focuses on the Registration Scheme and Section 8 details our assumptions that lead us to outline the consequences for the projected levy and registration fees in 2013/14

Overall, the proposed cost of regulation for 2013/14 is **£4,301,849** taking into account a change in VAT status. Like for like, the overall cost of regulation decreased by 0.5% in cash terms and 3.7% in real terms taking account of the current rate of inflation. The cost of regulation is comprised of a core, levy-funded budget of **£3,937,503** and a Registration Scheme budget of **£364,346**. This represents a like for like, real terms reduction of 4.2% for our core functions, taking into account the current rate of (RPI) inflation.

Excluding the change in VAT, this core budget has decreased in real terms since 2010/11 by 24.5%. These reductions represent our commitment to reduce the overall cost of regulation over time, where we can, without jeopardising our effectiveness as a regulator. However, as a small organisation our capacity to continue such a reduction will gradually diminish – there is a point below which a cost reduction could seriously impair the effectiveness of the regulatory regime which in turn would undermine confidence in the market we regulate. As we move forward we believe the ability to make further savings will increasingly be driven by transactional activities (such as complaint volumes and investigations) which to some degree are within the control of industry in terms of the overall levels of compliance. The current climate of rising complaints, if it were to continue, would therefore constrain our capacity to make additional savings in the future.

Feedback and comment

This being a consultation document, we are keen to gather stakeholder views on our Business Plan priorities for next year, as well as on the budget we have proposed to allow us to deliver against our objectives. Information on how to respond is contained in the final Section of this document. **The closing date for responses is 16 January 2013.** This period of time allows us to seek approval from Ofcom for the budget and publish the levy in good time for the start of the financial year on 1 April 2013.

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. Following the drawing-up of our second Three-Year Strategic Plan (2011/14), we took the opportunity to review, and then consult upon, our Vision and Values. As a consequence, we decided that our Vision remained fit-for-purpose but that some modification was appropriate in respect of our Values. These are re-stated below.

OUR VISION

1.2 Our vision is that anyone can use PRS with absolute confidence.

OUR VALUES

Effective

1.3 We want a market in which the public can trust services in the knowledge that they can exercise choice with confidence. A market, too, in which businesses can trust in a well-designed Code, proportionately enforced, that allows them to invest and innovate with confidence. We pre-empt and prevent problems in the market we regulate and deal with misconduct in ways that ensure it does not happen again.

Accessible

1.4 We are a well-understood and easy-to-reach first port of call for advice, information and support for consumers, providers, Network operators, the media, government and public agencies.

Independent

1.5 We will listen to both sides of the story, look at the facts and act decisively but always on a basis proportionate to the size of the problem. We will always work with industry and other bodies to build our understanding and improve our effectiveness. But we will not lose sight of the importance everyone places on the independence of decisions relating to our Code and its enforcement.

Collaborative

1.6 We will work closely with all interested parties to encourage a safe and dynamic regulatory environment. We aim to be more enabling, creating a climate for investment and innovation.

Principled

1.7 We ensure that real choice and genuine security are created by the standards we set. We aim to build more trust across the market.

Efficient

1.8 We will continually strive to deliver our activities efficiently, challenging ourselves to find new ways of working and improved systems and processes that reduce the costs of regulation, without undermining the quality of the protection we offer consumers.

Transparent

1.9 We will aim to share all relevant information on activities and will respond to all reasonable requests for such information. We will always be open and transparent in our dealings, unless in doing so we would undermine our regulatory effectiveness or breach the rights of others to confidentiality.

Q1: During 2013/14 we will commence the preparation of the next Three-Year Plan covering the period 2015-18. Do you have any feedback on the continuing appropriateness of both our current Vision and supporting Values?

Section 2: Highlights in 2012

2.1 In our current Three-Year Strategic Plan (2011-14), we committed to undertaking a range of activities. We believe we are on track to meet these commitments and thus deliver the Strategic Plan in what will be its final year.

2.2 Whilst 2011 was about introducing the new Code and Registration Scheme, 2012 has been about working with industry to embed the new approach and making it work in practice. We always knew this would not be a straightforward journey, as it has involved some significant changes in how we apply regulation, such as moving away from a prescriptive to an outcomes-based approach, applying proportionate regulation throughout the value-chain and putting a much greater focus on due diligence and risk control at the Network and aggregator levels. We remain convinced that this is the right approach for an innovative and rapidly changing market.

2.3 We have had to embed the new regulatory regime at a time when changes in the market have created new challenges for regulation. The greater penetration of smartphones, whilst an undoubted positive for consumers, has created new opportunities for those who seek to mislead or to defraud consumers – for example, through mobile malware. We have also been concerned by the greater incidences we are seeing of misleading affiliate marketing, often but not exclusively, on social networking sites.

2.4 Incidences of consumer harm in the PRS market have been increasing over the past year. This is reflected in an increase of 93% in consumer complaints to us about PRS in the period April to September 2012 compared to the same period for last year. The challenge this year has therefore been to get to grips with these new drivers of consumer harm, using not only our established regulatory tools, but also innovative working with a range of partners, many of whom are outside of the PRS industry. We have also had to cope with growing demands on our services, from both consumers and industry, whilst continuing to achieve the reductions in the cost of regulation that the PRS industry has expected from us.

2.5 This has been a significant set of challenges. Whilst these challenges remain on-going and will be central to our Business Plan for 2013/14, we believe we have made significant progress in addressing them in 2012, as set out below.

In this section, we set out the highlights of the year in terms of key deliverables and in Annex B we detail progress overall against each of the actions we committed to delivering by the end of the Three-Year Plan.

Effective action against the malware threat

2.6 We are mindful of the potentially serious damage to consumer confidence from mobile malware attacks affecting UK consumers, especially now that ownership of smartphones is growing so fast. To counter this, we are taking a pro-active approach to tackling malware and have taken a number of steps to help make the UK an unattractive market for mobile malware attacks. In particular, we have worked with industry to quickly shut down mobile shortcodes that have been infected by malware. This has limited the consumer harm and has also blocked the proceeds that otherwise would have gone to the fraudsters. This year we have also issued our first sanctions, including fines, against a provider for failing to take the appropriate steps to protect the market against premium rate malware. In April we took the lead in the UK against mobile malware threats with a summit bringing together for the first time in the UK industry, regulators, law enforcement bodies and the information security industry to tackle this threat head on and agree actions designed to minimise the threat of systemic attacks. Work on this initiative is far from over and will continue into 2013 and beyond.

Industry engagement

2.7 Our work continues to be reliant on strong partnership with industry. Without the support of the vast majority of reputable providers and Networks we would not be able to provide practical regulation or take the action needed against that small minority who threaten confidence in the market through malpractice. At present we are drafting Guidance on misleading digital marketing both with input from the Industry Liaison Panel (ILP) which is made up of trade bodies and key providers from across the sector.

Relationship building with external partners including Facebook and Google

2.8 This year has seen an increase in co-operation with a number of external agencies and companies beyond the traditional premium rate market but who increasingly are involved in the provision or marketing of PRS, especially across the internet. As we move to a more interconnected mobile commerce ecosystem, more co-operation will be needed between regulators and a variety of companies to ensure that we can promote the benefits of new technology and mitigate the risks. We are particularly keen to work with companies whose platforms are integral to how PRS are increasingly being promoted and accessed by consumers. We are therefore in the process of establishing relationships with Google and Facebook, who have a common interest with us in ensuring that their platforms are not abused to mislead consumers. For example, Google amended their terms and conditions for Adwords, following concerns we raised with them about the misleading promotion of premium rate information, connection and signposting services through search engine marketing. We will look to deliver more through these and other external partnerships over the coming year and beyond.

Successful embedding of the PhonepayPlus Code of Practice (Twelfth Edition)

2.9 A key priority this year has been our focus on ensuring the benefits of the new regulatory framework driven by outcomes focused regulation are delivered. We have made good progress and informal feedback from all stakeholders continues to positively support the new approach. In September 2012, we launched a discussion paper on due diligence and risk control, a key element of the new Code. We charted some of the progress made in this area, whilst also highlighting the further work needed to ensure that the benefits of the new approach are delivered to their full capability. With the emergence of more internationalised PRS, longer value chains and a more complex market, developing the flexibility that the new Code provides has given industry space to innovate while ensuring we remain able to take targeted action to protect consumers. Examples of the advantages of the flexibility of the new Code include the growth of mobile app payments, with swift Guidance to clarify the outcomes for consumers, as well as the charity donations trial detailed below.

Confirmation of remit over Payforit and work with Payforit Management Group

2.10 Ofcom reached a conclusion to its scope review of PRS regulation in July. Ofcom concluded that Payforit should continue to be regarded as a Controlled PRS and therefore fall within PhonepayPlus' regulatory remit. However, Ofcom requested that PhonepayPlus consider an appropriate application of the Code based on the additional safeguards that Payforit provides to assist with consumer confidence. We have been working with the Payforit Management Group, which consists of the mobile Networks, payment aggregators and merchants that use Payforit to develop an appropriate application of our framework and to communicate that to industry. Work in this area will remain on-going as will our commitment to work with industry to support Payforit and associated developments in mobile direct billing.

Charitable donations

2.11 Charitable donations through premium rate are a rapidly growing part of the PRS market. It is now quite common to see widespread print and poster campaigns for charitable text donations and last Christmas ITV ran the first mass scale TV donation appeal based on text donations (via Text Santa). We have been working closely with the charitable sector to understand how PRS giving is being used by charities and consumers and how regulation can best allow the market to develop, whilst ensuring consumers are properly protected. To this end, we have undertaken a substantial piece of research into charitable giving by PRS and we have also been carrying out a pilot that has enabled charities to trial the use of a 'SKIP' function alongside quarterly 'STOP' reminders.

Application (App) based payments

2.12 As the market continues to evolve, we have seen app-based services gain ground with consumers beyond the early adopter groups, and PRS based payment is now a recognised payment option on an ever growing number of apps. In April 2012 we launched Guidance on app-based payment following input from the ILP at every stage as well as all parts of the value-chain, including app developers. For the first time Guidance is now in place that sets out clear expectations to those entering the PRS arena with apps, aiding providers to build consumer confidence. A key concern here has been ensuring that consumers have proper transparency around pricing – especially for in-app billing – and that they know how to disengage from an app-based service when they no longer wish to use it.

Prohibitions, bars and suspensions

2.13 A prohibition from involvement in the PRS market is a serious Tribunal sanction and we do not seek to prohibit any organisation or individual unless there is firm evidence that the provider has been knowingly involved in a serious breach or a series of breaches of the Code. Where such evidence is established we act robustly to drive out such deliberate or persistent behaviour and to protect consumers from serious harm. This year the PhonepayPlus Tribunals have prohibited from the premium rate market three individuals, five providers and one Network, and the Executive has suspended (using its power under the Code) one provider who has refused to comply with Tribunal sanctions with two providers barred through a Tribunal upholding breach of sanctions against them. Prohibitions remain necessary to remove individuals or organisations that pose a serious threat to consumer confidence in the premium rate industry, thus protecting consumers and the interests of the vast majority of responsible providers.

Section 3: The market and other external conditions

Against the backdrop of increases in consumer complaints, this section provides a broad overview of the premium rate market as our research and intelligence portrays it.

3.1 The diversity of PRS in the market is limitless and to the extent that it is, defining a 'market' for PRS beyond core products is a challenge. These markets vary widely in their service propositions and are becoming increasingly diverse in terms of the promotion and marketing techniques.

3.2 We are preparing to carry out our Annual Market Review, which will provide us with data about the state of the industry and market in its widest context. This will be used to subsequently inform regulatory activity as well as providing a useful data set to providers for whom premium rate is a core business proposition. The 2011 market review reported a decline in the PRS market of 6.4% to £796.5 million. This was largely due to the decline in traditional PRS such as Directory enquiries and adult chat lines. Whilst we do not have Market Review data for 2012 yet available, we do know from our levy returns data for the first two quarters of 2012/13, that overall the market appears to continue to be relatively flat with some areas of decline (such as 090 and Directory enquiry) being compensated for by some areas of growth (such as Payforit). This data is supported by softer intelligence obtained from the market and numerous providers who report varying patterns of decline alongside some opportunities for new growth.

3.3 The rise in uptake of connected devices means that smartphones and tablets are playing an increasingly important role in accelerating some of the market shifts that have been occurring for some years now. The traditional markets (e.g. adult, Directory enquiries, information and advice services), and some areas of digital content face on-going challenges because consumption habits are changing. For example, consumers may use Google to look for email addresses and phone numbers instead of using a paid-for Directory enquiry search. At the same time, the traditional markets for ringtones and wallpapers have diminished considerably as mobile personalisation has for the most part moved beyond paid-for ringtones and wallpapers and smartphone music capability has been transformed. Equally richer smartphone technology will present opportunities to innovate in the marketing and sale of digital content.

3.4 The evolution of the global dimension of the digital marketplace has provided opportunities to use PRS alongside or in competition with other micropayment methods to monetise new forms of content and services. In parallel with this, new digital marketing channels have opened up, and with that some sectors of the market have thrived because of opportunities to partner with affiliates in the digital marketing space. Affiliate marketing is a form of digital marketing that drives traffic, either through social media or search engine optimisation, to a particular website and service for a commission. This is a rapidly growing area that is related to a number of industries and it most often operates across national boundaries. However, with this we have seen a considerable rise in complaints driven by affiliate marketing practices, in particular in relation to quiz and competition services, and it is clear that there are challenges ahead for industry to ensure that best practice is followed by their affiliate partners.

3.5 As reported in Section 2, this year there has also been concern about the increase in mobile malware that abuses premium rate and causes serious consumer harm. This is still an area in its infancy but a number of information security organisations have raised concerns about the rise of mobile malware as smartphones and apps become more sophisticated. PhonepayPlus and the PRS industry have worked collaboratively to ensure that malware attacks have not been able to cause widespread consumer harm and gain a

foothold in the UK PRS market. Both regulator and industry need to apply continued vigilance in this area.

3.6 Both affiliate marketing and mobile malware are international in dimension occurring across boundaries, making use of the opportunities offered by the internet, and by aggregators and resellers that provide international offerings.

Q2: Do you agree with our assessment of the PRS market and do you have any other information or data that you could share?

Section 4: Overarching themes for the year ahead

4.1 This year will be the last in our current Three-Year Strategic Plan (2011-14). That plan covered the period in which we have delivered our new regulatory framework for PRS based on three core value propositions:

1. An outcomes-based Code with fewer rules;
2. Lighter level of intrusion for minor breaches through an informal resolution process; and
3. Targeted regulation bearing down more heavily on the 'polluters' rather than the intermediaries.

All of this was delivered in return for tighter standards of due diligence and risk assessment amongst Networks and aggregators to keep the most persistent and obvious offenders out of the market.

4.2 We recognise that these changes are a considerable shift in the way regulation in PRS has operated over the last 25 years. The changes needed on the part of industry providers could not happen overnight and nor have they. Importantly however we believe that despite some negative trends and patterns in the market, in part as manifested through rising complaints, our changes remain the right ones and are delivering improvements for consumers and businesses alike. But the journey of change is not complete and we see five critical issues in the market that need addressing. These are:

- A continuing failure on the part of some to give effect to their responsibilities for due diligence and risk assessment and control;
- An increase in complaints driven by a minority of providers for whom the incentives to compliance are not yet strong enough;
- An ever present risk to consumers, including vulnerable consumers, of harm arising from new issues such as mobile malware, misleading digital promotions and other internet-based affiliate programmes which mislead;
- The increasing likelihood that the customer experience when problems occur can be sub-optimal by reason of lengthy and increasingly complex value chains; and
- A growing recognition that PRS is competing in a fast-changing payments landscape of online and digital micropayments.

4.3 Taking the critical issues described above, we believe it is imperative that we therefore give priority in the 2013/14 business plan to three areas which will form overarching themes to our work plans in the next financial year. These are:

Theme One – Strengthening compliance

Building compliance through improved due diligence & risk assessment and control:

4.4 We believe that whilst many Networks and providers have brought about changes to their internal processes to improve their controls around due diligence and risk assessment, we still see too many cases and examples where the root cause of the consumer harm could have been prevented or minimised had providers or Networks in the value-chain exercised

more control either before contract or during service delivery. Our recent discussion paper[1] on this issue offered a prognosis of the issues and this will form a key theme for work we will undertake in 2013/14 with the industry to drive further improvements.

Making polluters pay:

4.5 Complaints to PhonepayPlus about PRS have been increasing for some time, and were on an upward trajectory before the new regulatory framework came into effect. During the current year the Board has developed an enforcement and compliance strategy designed to ensure we prioritise and target our resources to most effect and tackle the root causes of harm, in conjunction with the due diligence and risk assessment work identified above. Allied to this is a wider piece of work designed to ensure that PhonepayPlus continues to make polluters pay for the costs and harm that they cause to industry and consumers alike. By continuing to ensure that polluters pay for the incremental cost of regulation borne by all providers, this will go to ensuring that our funding arrangements are equitable, fair and proportionate recognising that all providers benefit from effective regulation of the PRS market.

Theme Two – Improving consumers experiences

Improving the customer journey:

4.6 We are only too aware from the many consumers we speak to daily that the customer experience they have encountered when they incur a problem with a PRS can sometimes be sub-optimal. We recognise that lengthy value chains can cause consumer confusion but if trust and confidence in PRS is to grow then that journey needs to be seamless, straight-forward and simple to access. Alongside this, some phone companies would appear to be better than others at signposting their customers to us with the correct information so that we are ready and able to immediately assist them with their inquiry or complaint. As we will discuss in the next section of this paper, we propose to conduct further research this area in 2013/14 in order to work with providers and Networks on driving better customer satisfaction in this area.

Protecting vulnerable consumers:

4.7 This year we have seen an increasing caseload of investigations related to services that have preyed on the vulnerability of consumers, whether when in a rush to find the phone number for NHS Direct or through taking part in what at first appeared to be a simple word search competition in a newspaper or magazine, which attracted complaints from older people. Consumers who are vulnerable due to their personal circumstances require extra information and protection. Poor experiences for vulnerable consumers have a serious effect on consumer confidence and trust more generally in the PRS market. We must ensure that all consumers are clear about the costs of a service and its nature and that any information critical to their decision to use the service is not buried in small print. More generally, with the rapid growth of smartphone ownership by young people and children, we will take forward work to ensure that we continue to protect children and young people, including through our PhoneBrain initiative which targets users to build awareness and understanding about PRS.

[1] http://www.phonepayplus.org.uk/News-And-Events/News/2012/9/PhonepayPlus-issues-discussion-paper-on-due-diligence.aspx

Theme Three – Preparing for the digital future

Tackling the increasing risk from new online and security threats:

4.8 One driver of complaints and associated resource activity in 2012 has been from new forms of internet advertising, malware and misleading digital promotions. As we report earlier, we have instigated on-going preparedness to deal with quickly evolving mobile malware threats. In 2013/14, we will need to continue to develop our mobile malware strategy following the success this year in tackling this issue. We will also continue to identify further ways to engage with partners (such as Facebook with whom we have recently entered into arrangements to assist tackling with rogue affiliate marketing), to ensure that emerging threats, especially across the internet, can be effectively and speedily dealt with through a combination of enforcement powers and industry co-operation.

PRS in the future:

4.9 We recognise that PRS is increasingly becoming one online payment option which is competing commercially for consumers, who are presented with a range of options as to how they pay for digital content, across a multiplicity of devices. We need to ensure that we understand the implications of this, both in terms of our everyday regulation, and in terms of how we consider the future regulatory landscape as convergence of payments and communication networks and services takes hold. Now a year into the new Code we will be undertaking a preliminary assessment of the Code to identify what future changes may be necessary, to ensure that providers who offer PRS are not held back by regulation. In respect of future payments, we will be working with a range of other stakeholders to ensure we correctly assess the regulatory challenges as the future of payments unfolds including ensuring that any legislation that could affect this area is proportionate and future-proofed.

In the section that follows, we set out how we plan to ensure the issues and strategic themes identified in this section will be tackled through detailed work programmes alongside our business-as-usual activities.

Q3: What comments do you have regarding our themes for 2013/14?

Section 5: Themes into action

5.1 As described in Section Four, our overarching themes for 2013/14 give us direction to drive a range of key projects and programmes of work designed to address the five key issues that we see as priorities to be addressed over the coming year. These are set out below, and we have related them to the five objectives set out in our Three Year Strategic Plan (2011-14):

Strategic Objective 1

5.2 Create a proportionate outcomes-based regulatory regime for the PRS sector by launching and successfully implementing the new Code of Practice and industry Registration Scheme.

Our commitment

5.3 Having successfully delivered this objective we believe it right to ensure that the Code, the related Guidance and the Registration Scheme continue to remain fit for purpose as the PRS sector changes. We will continue to work with the ILP and other stakeholders to ensure that we keep the regulatory framework updated so that it meets the needs of industry in providing clarity and certainty as they innovate to develop new service offerings to consumers.

Work programmes

5.4 **Technical review of the Code:** We will review the new Code to identify areas of potential change to ensure that it and PhonepayPlus remain fit for purpose. In particular, the review will consider Part 4 of the Code to ensure that the relevant enforcement provisions maximise our opportunity to make polluters pay for burdens they place upon consumers both in terms of loss of confidence and financial detriment, which in turn impacts on the overall cost of regulation. It will also look at how the Code relates to the evolution of PRS as a micropayment. The technical review, once complete, will then feed into a fuller workstream involving an in depth Code review. We would expect to undertake the full review in 2014/15 through a clear and open consultative process at both the formal and informal levels.

Expected outcome: A clearly documented review, scoping areas of the Code which may require change and to determine where there could be scope to make Code changes which could incrementally drive improvement to the principle of making polluters pay.

5.5 **Develop market understanding about the future of payments:** We will be building our knowledge and understanding of future developments that arise from the convergence of telephony, the internet and finance. We will work with relevant regulators and professional bodies (such as Ofcom, the Payments Council and the new FCA), industry and government to examine these issues and develop proposals for how regulation can adapt to these changes.

Expected outcome: A better understanding of, and proposals for, how regulation can adapt to changes in the digital micropayments market to support growth and innovation.

5.6 **Work with Ofcom to ensure Higher Rate PRS and 070 enforcement are effective:** Ofcom's consultation on Higher Rate PRS (HRPRS) has now closed and Ofcom are currently considering responses. Ofcom's original proposals were that the current £1.53pm or drop charge spending cap on fixed line PRS should be raised, either to £3 or £5. PhonepayPlus is working with Ofcom to consider the effect of potential raised spending caps, both in terms of consumer risk and whether any changes to current PRS regulation will become necessary as a result of the raised caps. In addition, as we hold regulatory

responsibility where 070 numbers are misused to affect revenue-shared PRS charging, we will continue to assist with any research and consideration Ofcom undertakes in this area.

Expected outcome: Evidenced-based support to Ofcom as they review both HRPRS and the misuse of 070 numbers.

Strategic Objective 2

5.7 *Pre-empt and prevent consumer harm and build consumer trust by working with the industry to build in compliance to all emerging and developing PRS. Drive-up overall levels of compliance in the market through strategic use of monitoring to increased use of informal resolution of minor Code breaches.*

Our commitment

5.8 Feedback from stakeholders continues to tell us that our levels of pre-emptive engagement are helpful and much improved on previous years. However, we are not complacent. We will continue to work with the ILP and the industry more generally to identify ways in which we can better and earlier prevent problems and harm as well as build in compliance to new services. We will again in 2013 publish our research plan and engage stakeholders in their assessment of the research priorities as well as identify areas for fruitful collaboration and cost harmonisation.

Work programmes

5.9 **Work with providers and Networks to embed a culture of effective due diligence:** We will continue to engage with industry to build a culture of due diligence into companies. Effective due diligence can stop many problems before they come to market, reducing costs for industry from investigations and preventing loss of consumer confidence. We will build on developing closer supportive relationships in particular with Level 1 (L1) providers, such as aggregators, to assist them with developing their approach to due diligence and risk assessment. However, as we noted in our Discussion paper on this issue, our assessment in this area is that first and foremost, the quality of this work in providers is driven more by a commitment from leadership in the company than by processes alone.

Expected outcomes: Engagement with key L1 providers will be on-going and the number of Formal (Track 2) investigations linked to the same L1 providers will have reduced.

5.10 **Undertake a review of the consumer journey:** As the market changes and consumer journeys become more diverse we will continue to ensure that we understand consumer journeys. For example in 2011 we saw a 575% increase in PRS access through social media alone. These changes provide challenges for PhonepayPlus as a regulator and the industry to ensure that consumers understand the proposition and price of a service. We will undertake research to evidence the consumer journey experience when using PRS and from this work with industry to improve the customer care experience. This will include assessing the completeness and accuracy of information on Number Checker and the effectiveness of providers' complaint handling processes, and identifying further enhancements to Number Checker to assist consumers and capture intelligence.

Expected outcome: A clear evidence base about the nature and quality of consumer journeys such that a clear consideration off the issues can commence both formally and informally with stakeholders through engagement and consultation.

Strategic Objective 3

5.11 *Inform the development of the Code of Practice and targeted enforcement action by increasing the quality of intelligence about the PRS market and its consumers through more effective use of internal and market data, supported by targeted research.*

Our commitment

5.12 We have made considerable progress in building our market risk assessment to capture new and emerging threats. This allows us to target regulatory action to holistically manage problems and thus prevent harm. In the last year our work around mobile malware and Information, Connection & Signposting Services have both been the product of this activity. We will continue to work in this way and at the same time review how we best target enforcement action to ensure that the minority of providers who cause harm and detriment are prevented from doing so, and to ensure that the principle of polluter pays is effective.

Work programmes

5.13 **Deliver and embed the enforcement and compliance strategy:** Our strategy sets out our regulatory compliance and enforcement approach towards the optimisation of a compliant market. The strategy, which has been revised this year in specific response to the priorities and requirements of today's market, provides the framework which underpins decision making, prioritises allocation of resources, informs the business as usual activity and drives the business plan priorities. The strategy sets out a more integrated approach across enforcement, policy development, research, monitoring and adjudicatory solutions to optimise compliance. The focus will be in the coming year to delivery on our due diligence and risk management and control and polluter pays objectives. Insofar as the implementation of the strategy is impacts on the Investigation and Sanctions Procedure, this will be updated and re-published.

Expected outcome: Complaints will have reduced from current levels and action to tackle root causes will be in hand and having a positive impact on overall levels of compliance.

5.14 **Make polluters pay:** Following agreement with industry we will be taking further steps to ensure that it is the minority of providers who cause harm in the market that pay their share of the cost of regulation. We are currently reviewing our processes from end to end to ensure that those who cause harm pay for the cost of regulation. We recognise that there is no 'silver bullet' solution to ensuring that targets for fine collection are met, but we believe that through a combination of factors, including a further assessment of our Code powers in this area, we can make sustained progress in ensuring that the principle of making polluters pay – which is a principle shared and universally agreed with funders and stakeholders – is met and delivered in full.

Expected outcomes: We will consistently deliver on our targets for fine and administrative charge collections.

Strategic Objective 4

5.15 *Work with industry to assist consumers of PRS to increase their ability to use them safely and confidently.*

Our commitment

5.16 This objective continues to be at the heart of our proactive approach to regulating PRS. We recognise that unless consumers have confidence in PRS, there will be no longer term sustainable market for PRS and as such, no industry. We believe we have gone a long

way to delivering this objective as measured by the 58% increase in consumer confidence in pricing over the last two years shown in the 2011 Annual Market Review. However, we are not complacent and recognise that the complexity of the PRS value chain can militate against consumer trust and customer satisfaction. With the continued market penetration of smartphone ownership, increasingly by young people, our priorities for 2013 will recognise the need in particular to factor children into our work in this area.

Work programmes

5.17 **Work with partners on ensuring children can use PRS safely**: We have begun partnership work with Childnet to share best practice and raise awareness of our messages as well as continuing the award-winning PhoneBrain project. Following a 25% increase in those registered on the site during the 2011 programme we are continuing to build on our network of schools and youth clubs at the same rate of increase and currently have 1100 contacts registered. This work is of particular concern to us as more young people have access to mobile technology as well as the internet. We must ensure that young people are confident with PRS, this will allow them to clearly understand the cost of the digital content they desire.

Expected outcome: We expect to see an increase in both classroom/youth club participation in the PhoneBrain programme, as well as an increase in partners who can help us to disseminate key consumer messages and advice to both parents and children.

5.18 **Work with Get Safe Online and others to ensure consumers are informed about how to use PRS safely**: As mobile technology becomes more sophisticated we expect to continue to see a rise in the number of potential risks to consumers. Effective consumer education is therefore a key part of our regulatory activity. PhonepayPlus contributed to the Get Safe Online (the Government's preferred online security advice channel) 'Click and Tell' week in London and Edinburgh, as well as running an online information campaign encouraging consumers to check terms and conditions before putting in their number which is on target to engage 10,000 consumers by the end of November 2012. We have also issued a range of information and advice to consumers covering issues such as mobile malware and misleading digital promotions.

Expected outcome: We will continue to develop our partnerships with consumer facing organisations such as Get Safe Online, Citizens Advice and Which? to ensure that consumers are well informed about the use of PRS.

Strategic Objective 5

5.19 *Deliver effective and efficient regulation for the PRS sector through smarter use of resources and further investment in building knowledge and skills of PhonepayPlus staff.*

Our commitment

5.20 Since 2010/11 we have decreased in real terms our core budget by 24.5%. We will continue to work to be as efficient as possible, however, our capacity to deliver ongoing reductions in the cost of regulation will be heavily influenced by the levels of compliance in the market, which feed through into the volume of complaints and investigations.

5.21 **Introduce a time recording system:** This project will introduce time recording to key functions of PhonepayPlus including Investigations, Complaint Resolution and Industry Services. This will assist in ensuring comprehensive and detailed administration charges for cases heard at adjudication and other activity which attracts an administration charge i.e. prior permissions. We very much suspect that for some providers who engage in lengthy (legal) correspondence around investigations, they will face an incremental increase in

administrative costs which are currently under-recorded at present due to our lack of an effective time recording system. It will also assist in resource management and efficiency and effectiveness objectives. A pilot time-recording system is in operation within the Executive and we will be looking to introduce a software solution in the next financial year.

Expected outcome: A more precise calculation of cost drivers to assist business planning purposes, and administrative charges more targeted against those who breach the Code.

5.22 **Introduce new outcomes-based KPIs and other management information:** As we move to a more outcomes focused model for delivery of our regulation we will be updating our KPIs to best demonstrate our work and provide the most relevant information to stakeholders. This will give a clearer explanation of the market and our performance within it.

Expected outcome: A clear view from the Board about how and in what ways the organisation is meeting its strategic objectives.

Q4: Do you agree with our proposed work plans for 2013/14? If not why not?

Section 6: Resources and activities

Resources

6.1 As in previous years we will continue to deliver our strategic objectives whilst challenging ourselves to work in smarter ways and bear down on our resource costs. For the third year we are proposing a real terms reduction in our budget. This proposed budget is set against a 93% increase in complaints and a projected 50% increase in Track 2 investigation cases in 2012.

PhonepayPlus Expense Budget 2013/14 (including irrecoverable VAT impact)	Budget 2013/14	Budget 2012/13	Variance (Inc) / Dec	% Change	
Staff	2,383,079	2,376,477	(6,601)	0.3%	▲
Communications	103,250	103,850	600	(0.6%)	▼
External expertise	143,000	146,000	3,000	(2.1%)	▼
Legal	101,000	123,333	22,333	(18.1%)	▼
Intelligence	150,000	150,000	0	0.0%	▶
External audit & outsourced services	17,091	23,205	6,114	(26.3%)	▼
Overheads	289,229	295,029	5,800	(2.0%)	▼
Premises	314,321	306,914	(7,407)	2.4%	▲
Publications	10,550	10,740	190	(1.8%)	▼
Telecoms	52,884	44,030	(8,854)	20.1%	▲
Website	31,150	37,850	6,700	(17.7%)	▼
Depreciation	109,195	124,754	15,559	(12.5%)	▼
Total budget funded by Levy - excluding VAT	**3,704,749**	**3,742,183**	**37,434**	**(1.0%)**	▼
Estimated irrecoverable VAT 13/14 (12/13 restated for comparison)	**232,754**	**239,661**	6,907	(2.9%)	▲
Total budget funded by Levy - including VAT	**3,937,503**	**3,981,844**	**44,341**	**(1.1%)**	▼
Registration Scheme	361,883	344,437	(17,446)	5.1%	▲
Cross-charge VAT impact on Registration	2,463	2,463	0	0.0%	
Total including irrecoverable VAT impact	**4,301,849**	**4,328,744**	**26,895**	**(0.6%)**	▼
Total excluding irrecoverable VAT impact	**4,066,632**	**4,086,620**	**19,988**	**(0.5%)**	▼

Figure 1. (For breakdown of Registration Scheme budget see Figure 3)

6.2 The overall proposed cost for 2013/14 of PRS regulation is estimated to be £4,301,849. This includes irrecoverable VAT of £235,217. This £235,217 comprises of estimated irrecoverable VAT of £232,754 for 2013/14 and cross-charge VAT impact on registration of £2,463.

Our core levy-funded budget, excluding VAT, will be reduced by 1% in cash terms and 4.2% in real terms allowing for inflation, to a proposed budget for 2013/14 of £3,704,749 with reductions across the vast majority of areas.

The Registration Scheme budget has increased slightly to £364,346 including the estimated VAT adjustment. Overall the proposed cost, excluding VAT, of regulation for 2013/14 has been reduced to £4,066,632 a reduction of 0.5% in cash terms (and 3.7% in real terms when allowing for inflation) over 2012/13.

6.3 As previously announced, following a decision by HMRC earlier this year, our VAT status has now changed and PhonepayPlus no longer enjoys a full exemption from VAT. Taking VAT into account, the cost of regulation is £4,301,849 with the core levy-funded budget at £3,937,503.

Our partial exemption is limited to being able to charge for and recover input VAT on the Registration Scheme only. Insofar as we cannot therefore claim back all of our VAT, this will impact on the levy calculation for which more details are set out in Section 8 below.

6.4 In terms of the core Levy Budget, staffing costs remain our largest cost. Our small Executive (the headcount for which has been reduced through a combination of redundancies and natural wastage) is highly skilled and face the challenge of understanding a very diverse remit. As highlighted in the Market Review section earlier, the industry that we regulate is extremely broad and complex so our teams have to be highly knowledgeable about a vast range of services and issues, from adult chat lines to Payforit and mobile malware. We propose to increase the Staff budget in 2013/14 by 0.3% next year, to reflect the increased consumer activity whilst not compromising on retaining the skills necessary to be effective and knowledgeable about the PRS market. This increase relates to temporary staff costs only and will not flow through to future years budgets.

6.5 The increase in our proposed budgeted cost for telecoms next year is due to an over projection of the cost savings in the previous financial year together with additional costs for the migration to a Session Initiation Protocol (SIP) system. The adjustment for next year reflects the actual cost and provides for a £5,000 reduction in costs per annum on the previous telecoms set-up. Business benefits include greater levels of resilience, increased levels of service through the supplier contract and further flexibility in call management and routing options.

6.6 The only other area of increase in the core levy budget is the cost of premises and here the proposed increase is as a result of a planned increase in our rates for our building as determined by the local authority and as such outside of our control.

6.7 Further details about the Registration Scheme can be found in Section 7 of this document.

Activities

6.8 As well as producing a budget based on an accounting based expenses model, for some years now we have also looked at our cost drivers through an activity based model, aligned to the core functions we deliver through enforcement and support to consumers and industry. As detailed above our core budget is proposed to be reduced by 1% (4.2% in real terms allowing for inflationary impact). However, the proportion of this reduced budget allocated to activities is proposed to vary reflecting the priorities for 2013 identified earlier. These changes reflect changing priorities and needs, in the short-term principally as a consequence of increasing complaint volumes which will take time to be reduced. These areas are detailed below.

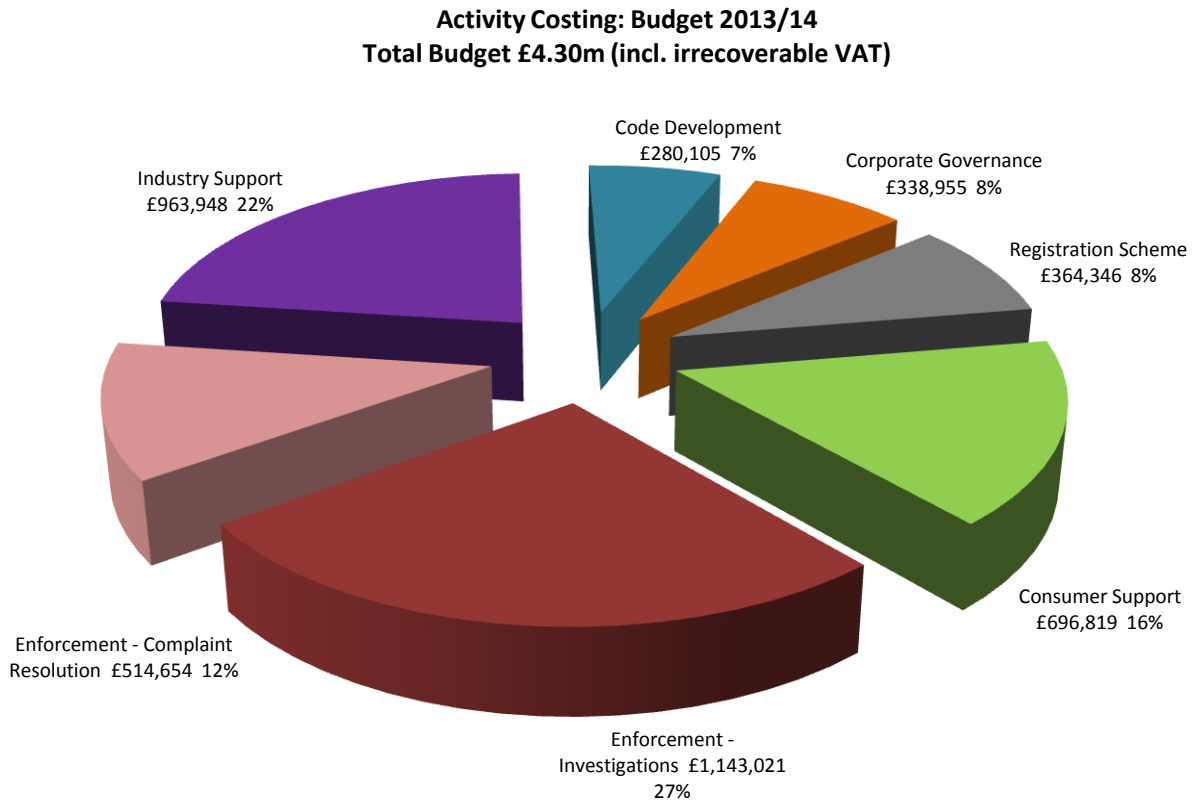

Figure 2.

Consumer Support

6.9 The significant rise in enquiries and complaints over the last year presented a challenge for the Consumer Services team. In addition to increased volumes the increasingly complex market – longer value chains and the increase of app-based services and affiliate marketing practices – has served to confuse the consumer and often added some difficulties in understanding the nature of the complaint. Our customer service provision is monitored on an ongoing basis to ensure the best intelligence is gathered from consumers and we continue to provide the most effective resolution to enquiries and complaints.

6.10 New processes introduced this year streamlined the complaints process and involve greater cross team working to make the most of expertise in identifying serious harm earlier, particularly given the emerging trends in the market, and ensuring the most appropriate resolution track. This is part of an approach designed to integrate working between the Research & Market Intelligence, Consumer Services, Complaint Resolution, Investigations and Legal teams to ensure the most efficient and effective regulatory action.

6.11 We have been pro-active in building confidence amongst young people in their use of premium rate. This will continue to be achieved through the award winning PhoneBrain initiative.

6.12 We therefore propose a budget increased by 4.5% to £696,819 for Consumer Support in 2013/14, to provide a good service for the the increased volume of consumer interactions.

Industry Support

6.13 There has been a small decline in requests for compliance advice (albeit an increase in more straight forward enquiries). However, the service is still valued by a large number of providers.

6.14 We are committed to giving industry strong support to ensure that the Code is followed, consumers are protected and that confidence in the market is maintained. This is vital to building a strong industry.

6.15 We will continue to hold regular ILP meetings as well as other engagement events to hear the views of industry and further understand the pressures on the market.

6.16 Industry Services now have delegated powers from the Board to administer applications for those services requiring prior permission, speeding up the process in the majority of cases.

6.17 We propose a budget decrease of 7.3% to £963,948 for Industry Support in 2013/14.

Enforcement

6.18 Enforcement is our core function, as such it is the largest area of spending and accounts for 39% of our overall budget (although some is recovered through administration charges). It is sub-divided into complaint resolution for minor harm that can be more readily addressed and investigations for more serious harm that requires a formal regulatory course of action.

6.19 As referred to above we are emphasising inter-team working to move complaints and monitoring information more effectivelty into the appropriate enforcement tracks while identifying the root causes of harm.

Complaint Resolution

6.20 Complaint Resolution has seen a small reduction in budget. This reflects the more serious nature of the cases reported to us, requiring a shift of resources to Track 2 Investigations. Complaint resolution remains a key tool and is used where appropriate to provide swift, and proportionate resolution for both the consumer and the service provider utilising the fast track and Track 1 informal procedures and to assist in the pre-liminary information gathering of potentially more serious cases.

6.21 We therefore propose a budget decreased by 8.1% to £514,654 for enforcement through complaints resolution in 2013/14.

Investigations

6.22 We have seen an increase in formal enforcement (investigations) cases, rising from 43 cases heard by the Tribunal in total in 2011/2012 to potentially over 65 cases in 2012/13, an estimated 50% increase. The expanding caseload has been compounded by the increased complexity of investigations as overseas providers, mobile malware, affiliate marketing and long value-chains provide a challenging environment for investigators. We expect the increase in this area in the short-term to continue as we work through the systemic non-compliance issues in the market including those generated by failures of due diligence assessments by Level 1 providers.

6.23 We therefore propose a budget increased by 7.1% to £1,143,021 for enforcement through investigations in 2013/14.

Regulatory development

6.24 There is a need to maintain and further exploit the flexibility which the new Code gives us. Policy must be equipped to react to new and evolving consumer harm rapidly.

6.25 The increasing complexity of the premium rate ecosystem, coupled with the introduction of a more flexible Code, means there is an increased workload for developing clear and effective policy and guidance for industry. Next year we will see the beginnings of a review of the new Code in preparation for a broader review in 2014/15.

6.26 We will continue to maintain and build relationships with industry stakeholders – the other main role of the regulatory development function. Ensuring good relationships with a wide range of industry stakeholders ensures that the organisation can gather intelligence and insight, which both informs policy development and enables us to pre-empt any potential consumer harm. In addition it allows effective dissemination of policy and other organisational messages.

6.27 We therefore propose a broadly equivalent budget of £280,105 for Regulatory Development in 2013/14.

Corporate Governance

6.28 This year we have seen a continued reduction in corporate governance costs, although the proportion of our budget spend on governance remains the same. As a small organisation we must ensure that we operate effectively and meet our statutory and other duties as a public body in law.

6.29 We will continue to look for cost-saving measures to drive efficiency against a backdrop of rising costs from rates, and utilities and other services where contracts and costs and increases in inflation are passed on by suppliers.

6.30 We therefore propose a broadly equivalent budget of £338,955 for Corporate Governance in 2013/14.

Optional activities

Funding Review

6.31 Some providers from the fixed-line part of the industry have raised with us a concern around the fairness of the current funding model for PRS regulation. A flat-rate levy means that all providers pay proportionately the same towards the cost of regulation. The concern that has been raised is this may mean that the fixed line part of the industry is in effect subsidising the mobile part of the industry, given that the majority of the complaints we deal with derive from mobile.

6.32 PhonepayPlus does not have a fixed view about our funding model. We favour a funding model that is fair, efficient to collect and administer and that commands the widest possible support of industry, and we are open to suggestions as to the best way of achieving these outcomes.

6.33 However, whilst we recognise the concern that has been raised with us, we do not think the rationale proposed for changing our funding model is straightforward and changing our funding model would also pose a number of challenges:

- Complaints alone are not an accurate measure of the share of regulatory resources devoted to particular parts of the industry. The relatively low proportion of complaints

concerning fixed line understates the proportion of our resource currently devoted to it. We have had several high-profile adjudications this year that have concerned fixed line providers. There are also a number of other workstreams, such as our consultation on information, connection and signposting services (ICSS) and taking forward higher-rate PRS with Ofcom, that specifically concern fixed line. Moreover, there are other core parts of our work, such as the resources we are putting into strengthening due diligence and risk assessment and control, that apply right across the PRS industry.

- Under our current model, fines collected through our sanctions process are returned to all levy providers. This means that fixed line providers benefit from fines collected from mobile providers, offsetting their levy for the following year.

- Whilst regulators like Ofcom or the FSA have separate charging regimes for some of the different sub-sectors they regulate, the rationale for this lies in their wider regulatory span and the diversity between the sub-sectors they regulate. This is not true for PhonepayPlus, as PRS is already a small and relatively coherent sub-sector of the telecommunications market. It is therefore questionable whether sub-dividing PRS further, in terms of different charging regimes, would be appropriate.

- If we were to move to a model with different levy rates for different parts of the industry according to the level of harm they created, this would not be straightforward to implement. Firstly, one would have to decide how to sub-divide the industry. Whilst a fixed versus mobile divide is relatively simple, the rationale such a division would be vulnerable to challenge on the same grounds that the current single PRS levy rate is – i.e. 087x providers might question why they should pay the same rate as 090x providers or Payforit providers the same rate as those using PSMS. We could therefore end up with a very complicated regime with different levy rates for each different number range or type of service. Second, PhonepayPlus would have to calculate in more detail the amount of resources being devoted to different parts of the industry and calculate and collect the different levy rates accordingly. This would add further complexity, costs and risks to our business planning, budget setting and levy collection processes – with the extra resources involved increasing the costs of regulation. A more complex levy regime will also be more difficult and resource intensive for industry to comply with.

6.34 In view of these issues, the last comprehensive Funding Review (carried out three years ago by KPMG) concluded that the current funding model, whilst not perfect, remained fit for purpose and enjoyed wide stakeholder support.

6.35 Our view therefore is that there is not a strong argument for changing our funding model at present and that an easier, and preferable, way of addressing potential inequities is to focus on making polluters pay for the harm they cause, with the fines collected then reducing the costs of regulation for the rest of the industry. This is reflected in our commitment that making polluters pay will be a central theme of our business plan for the coming year.

6.36 However, if there is a widely held view amongst the PRS industry that we should review our Funding Model at this time, then we can take such work forward. This would mean adding £100,000 to the current core budget as external consultants would need to be commissioned to assess alternative funding models and model their impacts.

Q5: Do you agree with our planned resource allocation and activities for 2013/14? If not, why not?

Q6: Would you support extra cost for a Funding Review in 2013/14?

Section 7: The Registration Scheme

7.1 The Registration Scheme is the mandatory central repository for registration details of all those providers operating in the PRS market and the services they provide. From an industry perspective, the emphasis that we place on good due diligence and risk control in the new Code is supported by the Scheme's due diligence reporting functionality and for consumers the Number Checker facility on our website remains a popular tool. We are pleased the easy access to data and the further transparency the Scheme has brought has resulted in positive outcomes for both stakeholder groups.

7.2 We received 731 new registrations in the first two quarters of 2012 and we now have 3057 companies registered. 64% of those registered are payable organisations and 36% are exempt from payment (charities or those organisations earning less than £10,000 in PRS revenue in their first year of operation). On average 700 due diligence checks are carried out per month by registered providers and 40,000 number checks per month are undertaken by both consumers and industry providers.

7.3 The Registration Scheme budget shows an increase next year, primarily driven by contractual increases in support costs from the vendor of the CRM which are agreed and contracted for over the lifetime of the current contract.

7.4 This year saw the introduction of search function on the unique Registration ID to assist in looking up organisations for due diligence purposes and to assist in completing premium rate service information. We also built in flexibility for the registration of voice short codes due to developments in this area by industry.

7.5 We undertook a renewals campaign in 2012 to assist the industry in renewing their registrations after the first full year of the Scheme in operation. Checks are undertaken on those organisations whose registrations have lapsed alongside verification checks on the accuracy and completeness of information provided across a range of data fields on the Scheme.

7.6 Despite the increase in budgeted cost we are pleased to announce that we do not intend to increase the level of the registration fee next year which will remain at the 2012/13 level of £135 plus VAT. This is possible as the costs over the seven years of the project are projected to remain manageable and sustainable. Built into this assumption of the funding model for the Scheme is the need to increase registrations fees to £150 plus VAT per annum from 2014/15 unless the overall number of paying registrants increases significantly and beyond our forecast.

7.7 We are retaining consistency in the fee model for the Scheme, and therefore the current model where charities and new businesses with PRS revenue under £10,000 are exempt for the first year of registration will remain in place over the next financial year.

PhonepayPlus Expense Budget 2013/14				
Registration Scheme				
	Budget 2013/14	Budget 2012/13	Budget Variance (Inc) / Dec	% Change
Staff	110,413	108,974	(1,439)	1.3%
External expertise	10,000	5,000	(5,000)	100.0%
Overheads	93,621	85,229	(8,392)	9.8%
Premises	14,490	16,054	1,564	(9.7%)
Website	22,721	18,541	(4,180)	22.5%
Depreciation	110,639	110,639	0	(0.0%)
Total excluding VAT	**361,883**	**344,437**	**(17,446)**	**5.1%**
Cross-charge VAT impact on Registration	**2,463**	2,463	0	0.0%
Total including irrecoverable VAT impact	**364,346**	**346,900**	**(17,446)**	**5.0%**

Figure 3.

Q7: Do you agree with our assessment that the charging model, and exemptions, should remain unchanged during 2013/14? If not, why not?

Section 8: The financial picture

The levy-setting process

8.1 While the Registration Scheme is funded by an annual fee, 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 reconciliation, with any additional monies owed to us paid over, and/or any excess payments made by the Network operators, on account, refunded.

8.2 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. 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 2012/13 – these monies are always returned to funders insofar as they go toward the cost of the future year's regulation and, therefore, reduce the amount we need to collect through the levy;
- Market developments in the preceding year – if the PRS market exceeds expectations in 2012/13, the additional levy collected would go towards covering the costs of 2013/14. On the other hand, a fall in the market in 2012/13 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 the possibility of winding-up of the organisation at some future point, without defaulting on obligations, and the need to deal with any new, exceptional 'spike' problems that require extra staff and legal or other resources, such as a widespread malware attack; and
- The overall impact of UK taxation policy, as it affects a company such as PhonepayPlus.

UK taxation policy

8.3 During 2012/13, PhonepayPlus VAT-able services were subject to a review by HMRC. We were in constant contact with the ILP throughout this process to update industry of the result and the likely effects. This review has now been completed and has resulted in change to PhonepayPlus' VAT registration status. From the 1 June 2012 the levy and fine charges fell outside the scope of UK VAT, meaning that we can no longer charge VAT on the levy and we are unable to recover the associated input VAT. This change means that we now have to incur the added costs of VAT, an estimated £233,000 per year. In the short term we have been able to cover the VAT for 2012/13 but for 2013/14 we have had to increase the levy to reflect this change to VAT. There was no change to the Registration Scheme and that service remains within the scope of UK VAT.

Non-adjusted levy and the adjusted levy

8.4 Figures 4 and 5 below show the unadjusted levy rate and the adjusted levy rate for the last few years and for the next period, as well as the core budget in both real terms and adjusted to account for inflation. These show that we have delivered substantial savings in the core budget since its peak in 2008/09. This has not resulted in a similar downward trend in the unadjusted levy rate because the market has been declining. However, savings in the

core budget have enabled us to keep the unadjusted levy broadly stable, when it otherwise would have risen substantially as a result of the decline in the market. Figure 4. shows the non-adjusted levy requirement for the last few years and a projection for the next period. This non-adjusted rate would be the levy we would need to raise, if we did not receive any other income (such as fines, administration charges or bank interest), and is relatively stable as it relates the total budget to the size of the regulated market. The adjusted rate is the amount we are required to levy once the costs of regulation are offset by other income. As this amount is subject to great variation, the actual rate levied can appear to change dramatically from year to year.

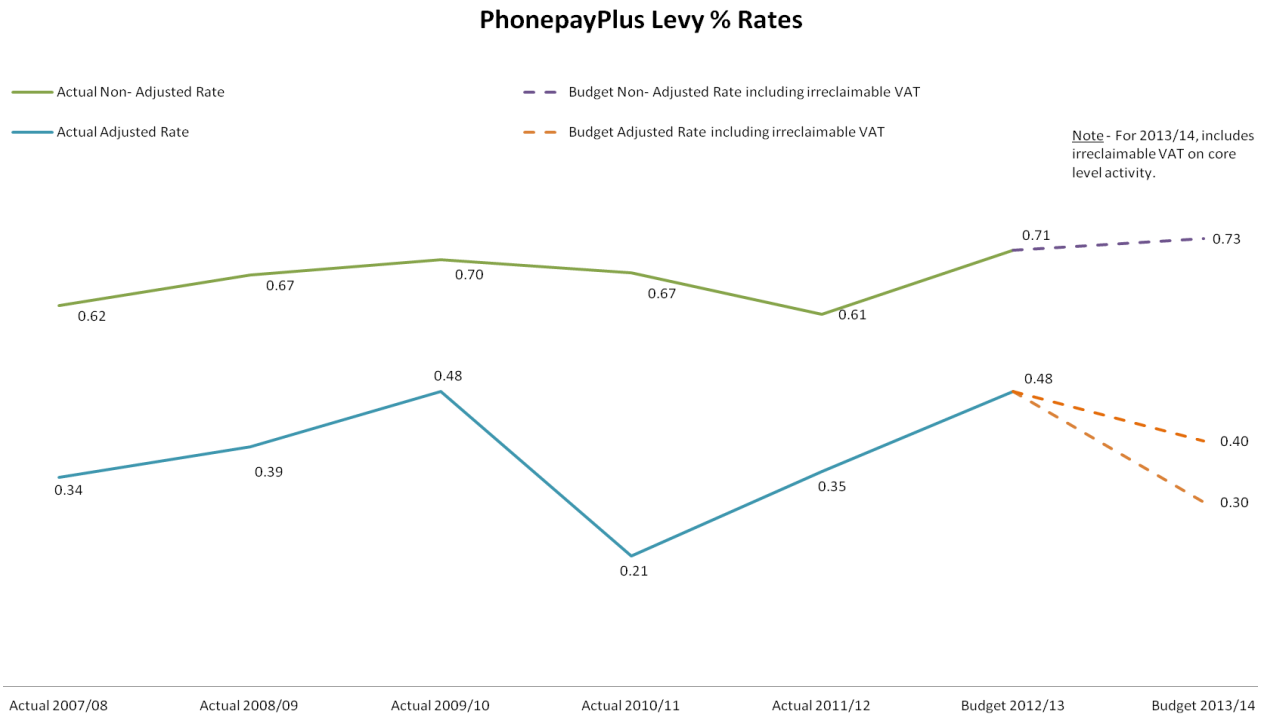

Figure 4.

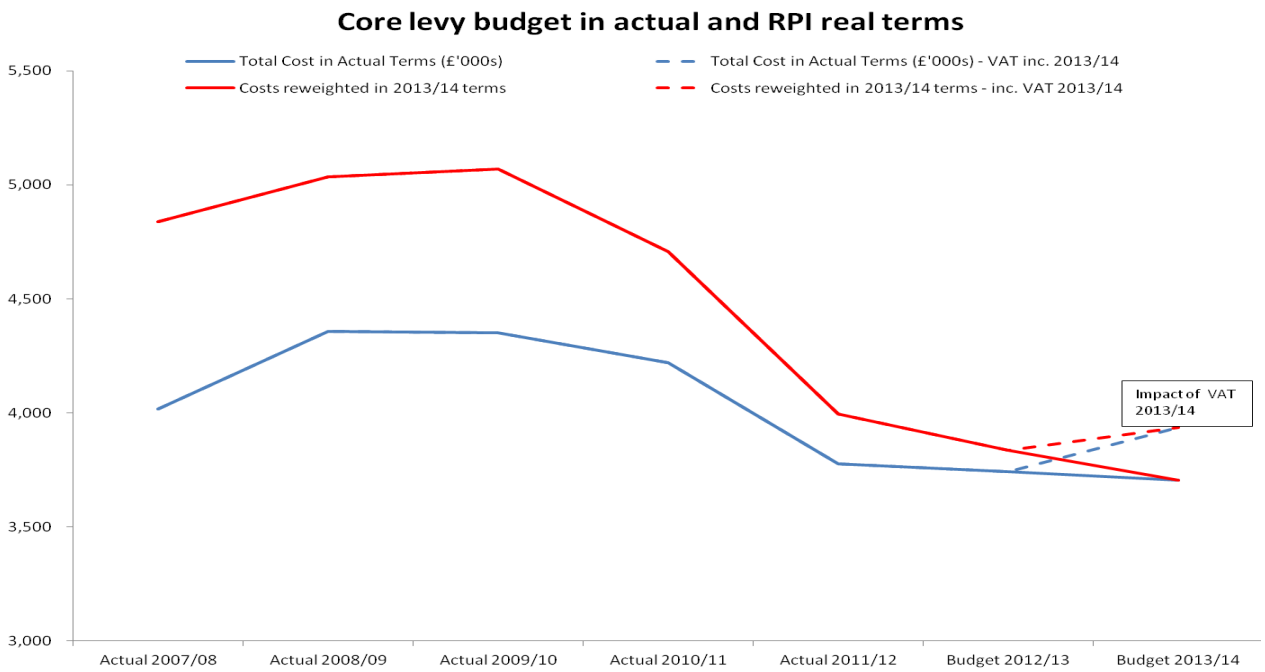

Figure 5.

8.5 The rate of our non-adjusted levy (before it is adjusted by the balance of fines and administration charges) takes into consideration two factors: the value of the market in relation to the value of our budget. A lower value market, therefore, can contribute to a higher non-adjusted levy, as we are seeing in the current year when the non-adjusted rate is expected to increase from 0.71 to 0.73%.

8.6 Notwithstanding our commitment to find efficiencies and reduce our budget, where possible, it is necessary to maintain a certain budget level to ensure effective regulation. This means that, should the Controlled Premium Rate Service Condition be narrowed in definition, the cost of regulation for the remaining market will inevitably be increased. Likewise, our business costs retain flexibility to gain from economies of scale and the non-adjusted levy rate would decrease, should our remit widen.

Our position on each of the issues identified is as follows:

The expected size of the market

8.7 Based on half-year figures, we believe that the market for 2013/14 will marginally decline from the 2012/13 position. The 2012/13 market review is being prepared and, by the time the levy is set in March, we will have the benefit of third quarter Network return figures, which means that we should be able to more accurately predict the market trend.

Administrative charges

8.8 The administrative and prior permission charges are reviewed annually and will be published along with the levy. We budget on the basis that we will recover and use in the same year a high percentage of the administrative charges levied.

Fines

8.9 Fines issued this year are lower than their peak in 2009/10 but are expected to be higher than the £0.9m levied in 2011/12 due to the level of fines issued to date.

8.10 Our policy will continue to be that we should not budget on the basis that fines will be levied and used in any given financial year, but that fines will be retained and be available to meet the funding requirements in subsequent years.

Contingency reserves

8.11 We have used our reserves to cover the changes in VAT for this financial year. For the period 1 June 2012 to 31 October 2012 we have incurred non recoverable VAT of £43,000.

Levy developments in the preceding year

8.12 An anticipated consequence of our preventative approach to harm would be that our levy would naturally increase this year – as a result of a reduction in fine income.

8.13 Levy outpayments were higher than forecast in 2011/12; therefore there is a £98,000 contribution in 2012/13.

8.14 Following the final approval of the budget by Ofcom, we will inform industry of the outcome and our levy requirements for 2012/13. Based on current projections and, in the absence of the latest information from financial returns from Network operators that pay over the levy, we would expect the adjusted levy to be decreased.

8.15 Our initial assessment, based on two quarters of Network returns only, suggests that this proposed budget, if approved following consultation, would lead to the levy being set within a range of **0.30-0.40%.** The levy will be lower than the current year (0.48%) due to the higher run rate of fines collected than in 2012/13.

Section 9: Responding to the consultation

Summary of questions

Q1: During 2013/14 we will commence the preparation of the next Three-Year Plan covering the period 2015-18. Do you have any feedback on the continuing appropriateness of both our current Vision and supporting Values?

Q2: Do you agree with our assessment of the PRS market and do you have any other information or data that you could share?

Q3: What comments do you have regarding our themes for 2013/14?

Q4: Do you agree with our proposed work plans for 2013/14? If not why not?

Q5: Do you agree with our planned resource allocation and activities for 2013/14? If not, why not?

Q6: Would you support extra cost for a Funding Review in 2013/14?

Q7: Do you agree with our assessment that the charging model, and exemptions, should remain unchanged during 2013/14? If not, why not?

We are seeking the views of all stakeholders on the proposals and questions contained in this paper by no later than 17 January 2013 (seven weeks from the date of issue of this document).

Where possible, comments should be submitted in writing and sent by email to: jmclarin@phonepayplus.org.uk.

Copies may also be sent by mail to:

James McLarin
PhonepayPlus
1st Floor, Clove Building
4 Maguire Street
London SE1 2NQ

Tel: 020 7940 7415

If you have any queries about this consultation, please telephone or email James McLarin 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: Key data

Outpayments per sector

Financial Year	Quarter	Mobile	Landline	DQ	087	Payforit	Totals
2010/2011	Q1	55,439,992	45,266,859	37,262,249	18,401,667	3,380,214	**159,750,980**
	Q2	54,682,718	41,941,108	38,047,101	18,149,041	3,625,628	**156,445,595**
	Q3	58,477,774	46,203,416	36,546,182	17,095,403	3,878,279	**162,201,054**
	Q4	58,515,164	40,465,883	30,524,150	16,616,640	5,980,575	**152,102,410**
Total:		**227,115,647**	**173,877,266**	**142,379,680**	**70,262,751**	**16,864,696**	**630,500,040**
2011/2012	Q1	50,623,678	40,551,649	31,113,889	16,296,526	4,501,230	**143,086,973**
	Q2	52,814,368	34,284,345	31,368,831	16,713,548	4,990,768	**140,171,859**
	Q3	58,810,890	37,457,691	29,614,277	15,707,149	7,536,227	**149,126,235**
	Q4	60,122,434	32,085,204	27,228,008	15,126,511	7,427,222	**141,989,379**
Total:		**222,371,371**	**144,378,890**	**119,325,005**	**63,843,734**	**24,455,447**	**574,374,446**
2012/2013	Q1	59,667,441	33,222,348	27,118,500	15,460,801	5,943,270	**141,412,360**
Total:		**59,667,441**	**33,222,348**	**27,118,500**	**15,460,801**	**5,943,270**	**141,412,360**

Annex B: Three-Year Strategic Plan (2011/14) – progress to date

Objective 1

Create a proportionate outcomes-based regulatory regime for the PRS sector by launching and successfully implementing the new Code of Practice and industry Registration Scheme.

We expect to:	Progress by year so far:
Deliver on the comprehensive plan for implementing the new Code and Registration Scheme and through that plan ensure a smooth transfer without unnecessary disruption or confusion to industry providers.	***2011/12*** A comprehensive implementation plan was rolled out by the Executive to ensure that stakeholders had all necessary materials, guidance and support available to them, so that they understood their changing obligations in time for enforcement day on 1 September 2011. ***2012/13*** Renewals functionality and new fee structure were successfully implemented.
Draw up a plan for reviewing and measuring the effectiveness, over time, of the new Code and Registration Scheme in terms of the impact on consumer outcomes and our vision.	***2011/12*** A plan was considered and approved by the Board, alongside a communications plan with stakeholders. ***2012/13*** The Board is in the process of agreeing a set of Key Performance Indicators (KPIs) designed to ensure that we can relate our effectiveness to performance. The implementation of these KPIs will commence in April 2013. During 2013 we will commence a technical review of the Code which will also assess the overall continuing effectiveness of the new regulatory framework.

	During 2013 a review of the effectiveness of the Registration Scheme will be undertaken.
Review the administrative charges we set under the Code and publish an updated schedule of charges in time for 1 September 2011.	***2011/12*** The administrative charges were reviewed and published in time for enforcement day on 1 September 2011. ***2012/13*** During 2012 a project has been commenced which will roll into 2013 which looks at all matters related to making Polluters Pay, including an ongoing review of the administrative charges and introduction of a time recording system for core investigatory functions.
Work with Ofcom to ensure that the PRS regulatory regime remains fit-for-purpose in a changing digital environment for micropayments.	***2011/12*** A dialogue at various levels, and involving the parts of Ofcom with interests in this area, was undertaken. Similar dialogues were held with other bodies (such as the FSA) as appropriate. ***2012/13*** We have worked with Ofcom on unifying our position around a submission to Government with respect to future Communications legislation as it relates to micropayments.

Objective 2

Pre-empt and prevent consumer harm and build consumer trust in PRS by working with the industry to build-in compliance to all emerging and developing PRS. Drive-up overall levels of compliance in the market through strategic use of monitoring and increased use of informal resolution of minor Code breaches.

We expect to:	Progress so far by year:
Periodically benchmark overall market compliance in order to determine compliance trends and report on these, as appropriate.	***2011/12*** Externally-commissioned market compliance reports provided us with quarterly updates in key areas of higher risk to consumers. ***2012/13*** Thematic research is focusing on misleading digital promotions. An in-house consultant is engaged on a number of thematic studies.
Issue timely guidance and other information to industry providers about emerging trends in the market so that providers can be aware of areas of risk that they should manage with care.	***2011/12 and ongoing*** This objective has now been incorporated into our 'business as usual' processes, and notifications are being issued to providers where trends have emerged, such as from recent adjudication trends.
Report periodically on trends in the use of informal resolution procedures in order to assist providers in building compliance into their services.	***2011/12 and ongoing*** An update on the most frequently raised Code provisions within the Complaint Resolution team is routinely included in the published quarterly report. Quarterly reporting, including informal trends, is a standing item on the ILP agenda.
Report on key trends in compliance failings and work with industry and trade bodies to drive improvements in the overall compliance with the Code of Practice.	***2011/12 and ongoing*** Work is ongoing to identify key trends and issues around consumer harm. These risks are discussed within the ILP, and in workshops and one-to-ones with trade bodies and key industry stakeholders, and actions are agreed.

Objective 3

Inform the development of the Code of Practice and targeting of enforcement action by increasing the quality of intelligence about the PRS market and its consumers through more effective use of internal and market data, supported by targeted research.

We expect to:	Progress by year so far:
Plan and publish an annual research and intelligence plan, outlining key areas of priority each year.	***2012/13*** Research plan was published in July 2012 and will be published annually going forward.
Ensure enforcement action is targeted on the appropriate point in the PRS value-chain and, in particular, bring enforcement action against due diligence and risk control failings where the evidence for this supports it.	***2011/12*** The introduction of the new Code of Practice (twelfth edition) enabled enforcement to be more effectively targeted on the appropriate point in the value-chain. ***2012/13*** Due diligence and risk management and control related cases have been heard at Tribunal and investigations into such cases are instigated as a matter of routine where the evidence supports such action. A Compliance and Enforcement Strategy has been approved to realise the benefits and expectations of the Code of Practice (twelfth edition), as well as to help utilise resources and approaches most effectively. An implementation plan is now in place for the strategy.
Work with industry to drive improved practices in due diligence and risk assessment and control in order to minimise opportunities for scams and sharp practices.	***2011/12*** Guidance on 'due diligence and risk assessment and control on clients' was issued alongside the new Code. Industry Services are trained to offer bespoke advice to individual providers. ***2012/13*** Due diligence and risk control forms part of our Enforcement Strategy (see above)

	and will be a critical area of focus during 2013.
Build strategic partnerships on research and intelligence with stakeholders to make best use of limited resources.	***2011/12*** New relationships were built with several Government agencies to share intelligence in relation to higher-risk areas. Other strategic partnerships were formed with other regulators, Government departments and agencies, including BIS, the OFT and the UK Payments Council. ***2012/13*** During 2012, we developed this activity further in the context of actions arising from the Malware Summit held in April 2012, including with GSMA. In addition we have had productive discussions with both Google and Facebook about PRS promotions on their platforms. With a view to making best use of resources and sharing costs where appropriate, our charities research has been co-funded by charities. AIME is contributing to early planning of the 2012 Annual Market Review, due for publication in the spring of 2013. We continue to maintain dialogue with other stakeholders groups.

Objective 4

Work with industry to assist consumers of PRS to increase their ability to use them safely and confidently.

We expect to:	Progress so far by year:
Launch a more robust and accurate Number Checker facility for consumers of PRS.	***2011/12*** As a by-product of launching the new Registration Scheme, all providers supplied the necessary records to populate the Number Checker. ***2012/13*** Number Checker function roll out has been completed and functionality requirements and business case for future developments are being reviewed for 2013/14.
Work with all phone companies to ensure that the provision of information to their customers about PRS is accurate and easily accessible.	***2011/12 and ongoing*** Monthly complaint and Number Checker data is shared with the MNOs and the information used to actively analyse problem services on their networks Intelligence is shared between PhonepayPlus and MNOs on Track 2 investigations in train, and any red or yellow cards issued accordingly. ***2012/13*** Improvements to the copy on the PhonepayPlus website consumer pages have been implemented and there is a programme of ongoing work to improve the user journey for consumers on the PhonepayPlus website, which will be completed by March 2013. In October and November, PhonepayPlus worked with Get Safe Online on a simple, clear and engaging campaign to encourage consumers to check terms and conditions before inputting their mobile phone number online, which is estimated to engage 10,000 consumers before the end of the campaign.

	MNOs have been asked to consider whether a Number Checker facility that is compatible with MNOs systems should be a business priority for PhonepayPlus.
Undertake mystery shopping exercises to understand what the consumer experience is when using PRS, particularly when problems are encountered, and work with the results from that research to improve signposting for consumers with enquiries or complaints about PRS. Develop research to understand consumer behaviour in the PRS market, including hard-to-reach consumers and those engaging with new technologies and services, and use the findings to inform policy development as well as monitoring and enforcement activities to ensure the pre-emption and prevention of consumer harm.	***2012/13*** Mystery shopping exercises will be completed by March 2013. Research into consumer behaviour will be completed by March 2013.
Work with children's and other groups to assist in ensuring that children are equipped with the skills necessary to manage PRS micropayments, especially on mobile devices, and to use services, where they choose to, with trust and confidence.	***2011/12*** PhoneBrain 2011 was launched in March and the competition closed in November 2011. As well as promoting to schools, we have this year partnered with Clubs for young people to roll out the programme and competition to a network of 3,500 youth clubs in the UK. ***2012/13*** We have reviewed and refreshed the teaching resources in 2012, including new video resources, with an emphasis on apps and micropayments. PhonepayPlus has developed a productive dialogue with Childnet and PhonepayPlus has presented to Europe wide groups interested in children's safety online via the Insafe network. The Board has approved a Children's Plan which will be published before the end of 2012.
Work with industry, other regulators and consumer organisations to ensure consumers can access PhonepayPlus at the point of need.	***2012 and ongoing*** This is an ongoing 'business as usual' activity.

Objective 5

Deliver effective and efficient regulation for the PRS sector through smarter use of resources and further investment in building knowledge and skills of PhonepayPlus staff.

We expect to:	Progress so far by year:
Continue over the period of the plan to seek reductions in our costs in real terms.	***2011/12*** This was the second year of the Three-Year Plan in which we proposed a reduced budget. Overall, this equated to a 19.6% reduction in two years, on which we have delivered. ***2012/13*** We propose further reductions in our total budget this year, with a decrease of 1.2% in cash terms and 4.4% in real terms taking account of the current rate of (RPI) inflation.
Review all operational processes under the new Code to ensure that we are maximising opportunities to work in the smartest and most efficient way.	***2011/12 and ongoing*** Work processes were reviewed as part of the work to deliver the CRM and Registration Scheme system. Process review is now ongoing as part of 'business as usual' activity.
Review our KPIs to ensure appropriate management of resources and effective performance.	***2011/12*** A plan was developed to review KPIs alongside the work to measure the effectiveness, over time, of the new Code and Registration Scheme. ***2012/13*** The Board is in the process of agreeing a set of Key Performance Indicators (KPIs) designed to ensure that we can relate our effectiveness to performance. The implementation of these KPIs will commence in April 2013.
Review the prior permission regime and ensure it is fit for purpose under the new Code.	**2011/12** The prior permission regime was reviewed and concluded that all regimes will continue under the Code of Practice (twelfth edition). Changes to who should

	seek permission and transitional arrangements to the new Code of Practice (twelfth edition) were published in a Notice to Industry in advance of the new Code implementation date. The Board will review the regime from time to time to ensure it remains fit-for-purpose. ***2012/13*** Standard prior permissions are now routinely administered by the Executive, with prior permissions that require policy decisions being dealt with by the Board.
Produce benchmark data on unit costs and, where possible, assess this data against equivalent information from other bodies in order to understand how costs can be challenged on an ongoing basis.	***2011/12*** Scoping work was completed. ***2012/13*** Unit cost data continues to be analysed.
Implement HR strategies to ensure that we have a workforce properly resourced and kept up to date with developments within the industry they regulate.	***2011/12*** The Leadership Team reviewed the skills and competencies of the Executive to ensure that we have a workforce that is fit-for-purpose in a changing environment. ***2012/13*** During 2012 the Leadership Team put in place a new Performance Management System designed to align key behaviours ad skills to on-going objective setting.