

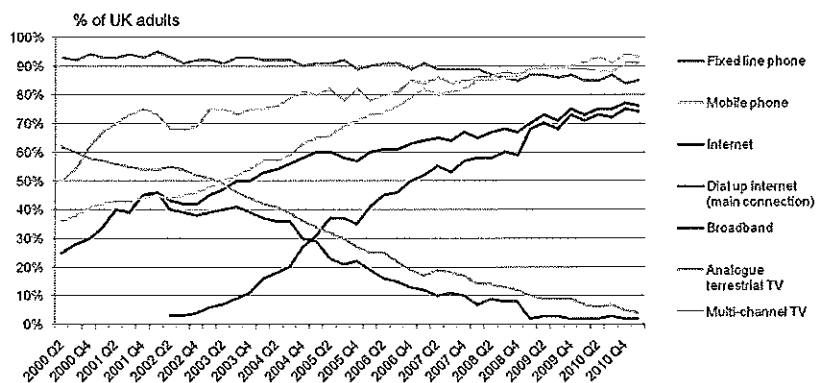
Post: Proposals for the Future Framework for Economic Regulation

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6th December 2012

Ofcom's regulatory responsibilities

- Ofcom is the independent regulator and competition authority (concurrent with OFT) for the UK communication industries.
- We regulate:
 - TV and radio,
 - Telecoms, and
 - Spectrum.
- Since 1 October 2011 our duties include regulation of postal services

The communications sector has changed, almost beyond recognition

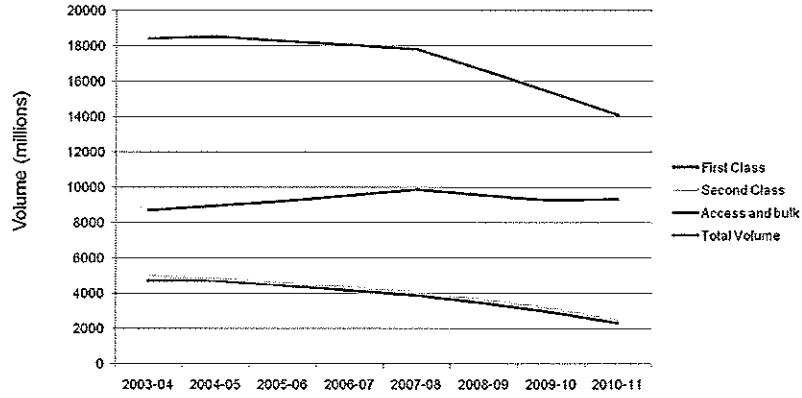


Source: Based on face to face survey data (Ofel/ Ofcom)

The way that we communicate, advertise...and shop...has been transformed as a result.

	Change: 2000 - 2010
• Mobile call minutes:	35bn ⇒ 125bn
• Fixed (voice) call minutes	174bn ⇒ 128bn
• Text messages:	7bn ⇒ 129bn
• Broadband connections:	0.05m ⇒ 19.5m
• On line advertising	£0.15bn ⇒ £4.1bn
• Online spending	£0.8bn ⇒ £58.8bn

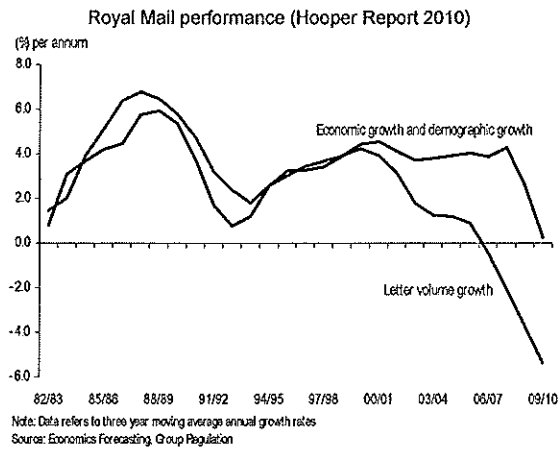
...as has our use of mail



Home delivered parcels rose from 208m in 2000 to 820m in 2008 (IMRG)

Former certainties have been undermined

- Delivered mail has fallen 25% since 2006
- Royal Mail delivered 84m letters a day in 2006 but 62m in 2010

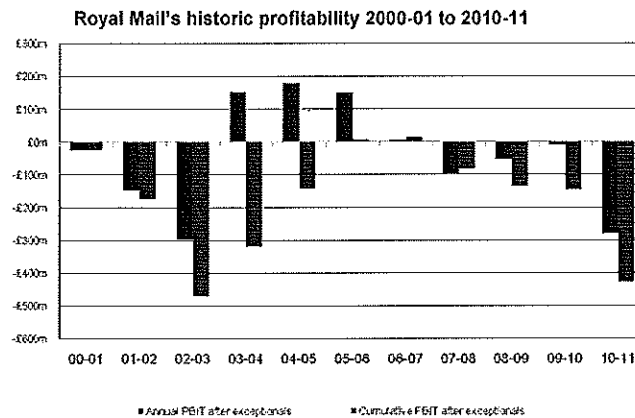


The sustainability of the universal postal service is clearly at major risk

Key Challenges:

- Demand and usage trends
- Efficiency
- Maintaining high USO service levels
- Pricing
- Royal Mail's pension deficit
- Profitability of Royal Mail

...As is reflected in Royal Mail's recent financial performance



Ofcom's duties under the Postal Services Act are very clear

Universal service

"Ofcom must carry out their functions in relation to postal services in a way that they consider will secure the provision of a universal postal service."

Efficiency

"Ofcom must have regard to –

- a) The need for the provision of a universal postal service to be financially sustainable, and
- b) The need for the provision of a universal postal service to be efficient before the end of a reasonable period and for its provision to continue to be efficient at all subsequent times."

The current regulatory regime is far reaching

- Price control of around 85% of Royal Mail's revenues
- Direct regulation of access prices
- Extensive prior notification and publication requirements

Ofcom could have decided to continue this traditional approach to regulation, but...

The conventional approach to regulation is not appropriate

- Price controls stop private operators from earning excessive profits while driving efficiencies.
- Price control regulation has failed in post:
 - Demand insufficiently predictable
 - Incentive mechanisms have not worked
 - Royal Mail highly constrained while facing a rapidly changing market



We have concluded that radical solutions are needed

The regulatory challenge:

- **In the short-term the universal service must be returned to a sustainable basis**
- **Royal Mail needs to make a commercial return and become more efficient**
- **Competition should be efficient and not undermine the universal service**

Our proposals are deregulatory and designed to help ensure sustainability of the universal service

- Change from detailed licence obligations to general authorisation model
- Removal of vast majority of retail and wholesale price controls
- Removal of direct regulation of access pricing
- Removal of the requirement for Royal Mail to maintain a guaranteed margin for access operators; known as access headroom
- Consultation on greater commercial freedom for Royal Mail before the end of the year

But with key safeguards

- Ensuring that a basic universal service product is affordable to all – a safeguard cap on 2nd Class letters
- Effective monitoring of Royal Mail's performance
- Competition within the mail market



Next steps – our timeline



Questions?