BERR | Department for Business Enterprise & Regulatory Reform

IMPACT ASSESSMENT OF THE POSTAL SERVICES BILL

26TH FEBRUARY 2009

Summary: Intervention & Options

Department /Agency:	Title:	
Department for Business, Enterprise and Regulatory Reform	**Impact Assessment of the Postal Services Bill**	
Stage: Final	**Version:** Final	**Date:** 26th February

Related Publications: 'Modernise or decline: Policies to maintain the universal postal service in the UK' (The Hooper Review) Cm 7529

Available to view or download at:

http://www.berr.gov.uk/consultations/ria/index.html

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What is the problem under consideration? Why is government intervention necessary?

The future of the universal postal service is under threat. Letters volumes are declining due to competition from digital media.

Government intervention is needed to enable Royal Mail (RM) to modernise and to bring the regulation of postal services within the context of today's communications market. Royal Mail's network of postal services has been developed over the years where it is the incumbent operator. Royal Mail's market power thus provides the rationale for regulation and partnership both to protect consumers and encourage increased efficiencies to protect the universal postal service.

What are the policy objectives and the intended effects?

The main policy objectives are: to sustain the universal service and maintain a publicly-owned, healthy Royal Mail; and to realise a positive future for postal services through effective competition regulated in the broader context of the communications market.

The intended effects are: a modernised Royal Mail that better serves the public, consumers and taxpayers, and makes the most of opportunities across Europe; and a new regulatory regime for the sector, reflecting the changing needs of consumers and the fact that post is part of the wider communications market.

What policy options have been considered? Please justify any preferred option.

The Hooper Review gathered evidence from a range of sources and considered a number of options. These are detailed in the 'Evidence Base' section of this impact assessment.

The Government intends to proceed with the report's central recommendations: to bring about modernisation of Royal Mail through strategic partnership; to enable Royal Mail to reap the rewards of modernisation by removing the historic pension liability; and to improve the regulatory framework. These recommendations, taken together as a package, will provide the best chance of a sustainable future for the universal service by ensuring a sustainable future for Royal Mail.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

The policy will be reviewed 5 years after implementation.

Ministerial Sign-off For final proposal/implementation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:

Pat McFadden ....Date: 26 February 2009

Summary: Analysis & Evidence

Policy Option: 2	Description: Implementing the Hooper Review package of measures

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition)	**Yrs**	Staff time spent on modernisation (PV = £8-11m)
£ 6.0bn	1	New pensions provisions implementation costs (PV = £205m)
Average Annual Cost (excluding one-off)		Transfer of historic pension liabilities / assets from RM to HMG – cost to HMG (PV = 6bn)
£ 21.3-21.6m		**Total Cost** (PV) **£ 6.2 billion**

Other **key non-monetised costs** by 'main affected groups'

Financial costs associated with modernisation are already accounted for; costs of merging OFCOM and Postcomm; costs associated with diversification and expansion.

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups' :
One-off	**Yrs**	Efficiency savings (PV = £2.6-3bn), Regulator savings (PV = £8m)
£ 6.0bn	1	Pension administration benefits (PV = £190m)
Average Annual Benefit (excluding one-off)		Transfer of historic pension liabilities / assets from RM to HMG – benefit to RM (PV = 6bn)
£ 280-320m		**Total Benefit** (PV) **£ 8.8-9.2 billion**

Other **key non-monetised benefits** by 'main affected groups': Social and economic benefits of sustaining the universal postal service; less management time spent on difficult relationship with the Regulator; more effective regulation of the sector; proceeds from sale of minority shareholding; further benefits of diversification and expansion.

Key Assumptions/Sensitivities/Risks: The identified costs and benefits of direct pension management are conservatively reported within the 10 year timescale. The average annual benefits have been estimated by dividing the present values by 10.

Price Base Year 2009	Time Period Years 10	**Net Benefit Range** (NPV) **£ 2.6-3.0 billion**	**NET BENEFIT** (NPV Best estimate) **£ 2.8 billion**

What is the geographic coverage of the policy/option?			UK	
On what date will the policy be implemented?			From Royal Assent	
Which organisation(s) will enforce the policy?			OFCOM	
What is the total annual cost of enforcement for these organisations?			£ 8.3m	
Does enforcement comply with Hampton principles?			YES	
Will implementation go beyond minimum EU requirements?			YES	
What is the value of the proposed offsetting measure per year?			£ N/A	
What is the value of changes in greenhouse gas emissions?			£ N/A	
Will the proposal have a significant impact on competition?			Yes	
Annual cost (£-£) per organisation (excluding one-off)	Micro **ZERO**	Small **ZERO**	Medium **ZERO**	Large **ZERO**
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices) (Increase - Decrease)

Increase of £ N/A Decrease of £ N/A **Net Impact** £ N/A

Key: **Annual costs and benefits: Constant Prices** **(Net) Present Value**

Evidence Base (for summary sheets)

Following impact assessment guidance, this assessment considers the economic impact of the proposed package of measures on all sectors of the economy - including business, consumers and taxpayers

1. Background

1.1 Government is committed to preserving the universal postal service, and to maintaining a healthy Royal Mail under majority public ownership.

1.2 At present, legislation governing the postal services sector is contained in the Postal Services Act 2000. In recent times, however, the communications sector has undergone significant changes. The digital media revolution is offering consumers unprecedented choice in how they communicate, leading to decline in the letters market. In addition, the liberalisation of postal services across Europe and the introduction of competition has led to new opportunities and challenges for service providers.

1.3 It was against this changing communications landscape that Government commissioned an independent review of the postal services sector, led by Richard Hooper CBE. The objective of the Review was to provide an independent analysis of the postal services sector and make recommendations on how best to maintain the universal postal service. The Review panel engaged a wide range of stakeholders, including consumers and their representatives, postal companies, trade unions, political parties, government departments, the devolved administrations and regulators.

2. The problem

2.1 The Hooper Review identified the main challenges and opportunities facing the postal sector and Royal Mail. The growth in digital media has prompted an unprecedented decline in the letters market. In 2007-8, Royal Mail handled 3m fewer letters a day than it did in the previous year, a decline of 3.2%[1]. In the same year, Royal Mail estimates that the substitution from postal services to alternative digital media reduced its operating profit by £500m. Alongside these challenges, the digital revolution has opened up new areas of growth, such as the delivery of internet purchases. The Hooper Review analysed Royal Mail's position in this changing market and identified five major factors which constrain Royal Mail's ability to respond:

i. Inefficiency. Royal Mail is much less efficient and profitable than its main European peers.

ii. Pension deficit. Royal Mail's historic pension deficit is one of the largest in the UK and is a major drain on the company's cash.

iii. Pricing. Increasing postal prices is no longer guaranteed to generate sufficient revenues to offset falling volumes.

[1] Page 48 of "Modernise or Decline: policies to maintain the universal postal service in the United Kingdom" 16 December - http://www.berr.gov.uk/files/file49389.pdf. Indeed, the decline over two years amounts to five million letters per day. http://www.news.royalmailgroup.com/news/articlea.asp?id=2378&brand=royal_mail_group

iv. Labour relations. The relationship between management and the Communications Workers Union is extremely difficult.

v. Relationship with the regulator. The relationship between the company and its regulator, Postcomm, is difficult.

2.2. The Hooper Review found broad consensus among postal companies, business users, consumer organisations, unions and the regulator that the status quo is untenable.

3. Policy objectives

3.1 The Government is committed to preserving the universal postal service. The universal postal service has two crucial elements – a national postal network and an affordable uniform tariff.

3.2 The universal postal service is of unquestionable economic and social importance to the UK. Many customers depend on the service for their communication and business needs and place a high value on its key features of a uniform, affordable tariff and a six-day-per-week service[2].

3.3 Royal Mail is the only company currently capable of providing the universal postal service throughout the UK[3], but it is facing significant financial difficulties in the face of a declining market. There is a strong social and economic rationale for addressing the challenges facing the company: namely the financial and organisational difficulties that are holding back modernisation, and the changing nature of the postal services market. Without intervention now, Royal Mail's finances will continue to decline, placing the future of the universal postal service and the company under threat.

4. Options

4.1 There is a broad consensus that the status quo is untenable. Government therefore considers that action has to be taken now to secure the future of the universal postal service. Doing nothing is not a viable option.

4.2 Section 3 of the Hooper Review considered options for addressing the difficulties facing Royal Mail. It concluded that all but one of these options were short-term solutions that would not address the fundamental problems in the longer term, or achieve the desired objectives (how to develop a vibrant postal market which can respond quickly to the changing needs of consumers; how to reduce the risks currently facing the taxpayer; and most important, how to maintain the universal postal service). The options considered were[4]:

i) *short-term cash-saving measures:*
Royal Mail could respond to current financial pressures with short-term cash saving measures. Hooper concludes, however, that this would offer only limited, short-term relief and would not resolve Royal Mail's financial difficulties in the long term. Without addressing the fundamental problem of Royal Mail's inefficiency, there is a strong

[2] For letters. Parcels are delivered 5 days per week.
[3] Page 48 of "Modernise or Decline: policies to maintain the universal postal service in the United Kingdom" 16 December - http://www.berr.gov.uk/files/file49389.pdf
[4] Page 66-68 of FN3

likelihood that the company would require ongoing subsidies, representing poor value for money for the taxpayer.

ii) the introduction of a compensation fund to share the burden of the provision of the universal service:
One option is to share the financial burden of providing the universal postal service across the market as a whole. This could be achieved by requiring postal companies to contribute to a fund, or by directly subsidising Royal Mail with taxpayers' money. Implemented now, this option would fail to address the underlying sources of Royal Mail's financial difficulties. It would not help to reduce the company's cost base in the face of falling demand and revenue. In the present situation, Hooper believed that compensation, from any source, would be counter-productive as it would considerably weaken the incentive for Royal Mail to adapt to changes in the market. Such compensation is, in any case, strictly limited under EU law.

iii) degrading the universal service to reduce the demands on Royal Mail.
Another option is to reduce the demands placed on Royal Mail by the universal service obligation. This is only feasible to the extent that standards set in the UK are higher than those required by the relevant European Directives. The service for letters, for example, could only be reduced from six days to five. And while the uniform tariff could be abolished altogether, prices would still need to be affordable. Although reducing the basic requirements of the universal service could realise savings for Royal Mail, the Hooper review concluded that this option would not address the underlying need for Royal Mail to modernise and could accelerate volume decline in the mail market. The Government is committed to maintaining the essential elements of the universal postal service for the reasons set out in section 3.2 above.

iv) modernisation – transformation to improve efficiency and reduce costs, and diversification and expansion to address the rapid structural decline of the letters market.
Given that a structural decline in the letters market is already underway, Royal Mail must be able to respond quickly and flexibly to the changing circumstances. This means modernisation, which the Hooper Review defines as transformation to improve efficiency and reduce costs, and diversification and expansion to address the rapid structural decline of the letters market. To achieve this, the constraints identified by Hooper (see para 2.1) need to be addressed swiftly and effectively.

4.3 To tackle the constraints faced by Royal Mail, the Hooper Review recommends a package of measures: a strategic partnership between Royal Mail and a private-sector company with experience of transforming a major business, ideally a network business; transferring historic pension liabilities to Government; and changes to the regulatory framework.

4.4 Bringing in a strategic partner will provide the corporate expertise that Royal Mail needs to modernise and increase efficiency. It is expected that a partner will help Royal Mail to accelerate the pace of change and improve the relationship between the company and the unions.

4.5. To maximise the benefits of modernisation and further enable Royal Mail to invest in diversification and expansion, the company needs to be relieved of the cash and balance sheet constraints imposed by the pension deficit. Hooper therefore recommends that, *provided the barriers to modernisation have been addressed,* the Government should take responsibility for the company's historic pension liabilities.

4.6 Finally, Ofcom should be appointed to regulate the postal market, reflecting the connection between mail and the broader communications sector. Ofcom will need a new set of tools to regulate the sector: wider-reaching powers, formal market analysis, and a significantly improved understanding of Royal Mail's costs.

4.7 The Hooper Review was clear that these recommendations are a package: each element is vital to secure the future of the universal postal service and Royal Mail. Strategic partnership will enable Royal Mail to modernise at pace, adapting to the changing market and the needs of consumers. Addressing the historic pension liability will enable the company to reap the rewards of modernisation and invest further in diversification. The proposed changes to the regulatory framework will place postal services in their rightful context, as part of the wider communications market. More effective regulation, with maintenance of the universal postal service at its core, will not only provide improved consumer protection but will encourage increased efficiencies.

4.8 The Government firmly believes that this package of measures is the only viable option to secure the future of the universal service. No single element of the package can achieve the necessary modernisation or tackle the fundamental difficulties facing Royal Mail. Each measure will play a vital part in removing the constraints on Royal Mail and enabling the company meet its current challenges, and securing the future of the universal postal service.

5. <u>Options appraisal</u>

This section compares the status quo (i.e. do nothing) with the Government's chosen option – implementing the Hooper package.

5.1 Option 1: Do nothing

5.1.1 The Hooper review explored a number of objectives: "*how to develop a vibrant postal market which can respond quickly to the changing needs of consumers; how to reduce the risks currently facing the taxpayer; and most important, how to maintain the universal service*". Hooper commented that "*the status quo will meet none of them*"[5]. As mentioned above, the review found **broad consensus** among postal companies, business users, consumer organisations, unions and the regulator **that the status quo is untenable.** According to Postcomm, "*without extensive change, the Royal Mail's business model will become unsustainable*"[6]. The title of the Hooper review - "*Modernise or Decline*" - also reflects his assessment that, in the absence of government action, the Royal Mail and the postal sector face an uncertain future.

5.1.2 **The UK letters market is already in structural decline** caused by the growth of digital media and communications. Royal Mail's revenues have been declining[7] and both the company and regulator agree that the number of letters handled by Royal Mail over the next ten years could fall by around a third.

[5] Page 104 of "Modernise or Decline: policies to maintain the universal postal service in the United Kingdom" 16 December - http://www.berr.gov.uk/files/file49389.pdf
[6] Page 59 of FN5
[7] Hooper cited two other reasons for a reduction in Royal Mail's revenues since 2005: introduction of postal competition, and substitution to cheaper products (from first to second class mail for example). It is worth noting that revenue lost to competition from digital media was five times the amount lost to competition from other operators.

5.1.3 **Royal Mail's financial position is not viable.** Over the past few years, revenue from its letters business has fallen while its operating costs (currently above £6.9 billion) have continued to rise. As a result, Royal Mail's letters business made an operating loss of £3 million in 2007. In its submission to the Hooper Review, Royal Mail indicated that its "*overall financial situation is becoming increasingly difficult*" and that the "*forecast headroom against the company's financing facilities allows little margin for error*"[8]. Royal Mail is the least profitable postal company in Europe, with profit margins well below its peers. In 2007, TNT (Netherlands) made an operating profit margin of 14.8% and Deutsche Post (Germany) 12.9%. In contrast, Royal Mail made an operating loss in 2007-08[9].

5.1.4 It has been suggested that, subject to regulatory consent, Royal Mail should simply increase prices to offset the effect of falling volumes. A comparison of first-class stamp prices (by weight) with other EU countries indicates that prices in the UK are relatively low[10]. Royal Mail's ability to increase revenues in this way, however, depends on the elasticity of demand: the extent to which demand for postal services will fall in response to an increase in price. When Royal Mail increased the prices of its products in 2007-08 by a weighted average of 5%, revenues fell slightly. Generally, demand will be more responsive to changes in prices the easier it is for customers to substitute to other providers or to other products. It is clear that there are alternatives to post, demonstrated by the effect which digital media has had on postal volumes. Customers can also switch to less expensive postal products such as second-class mail. It is a plausible argument, therefore, that demand for mail would be quite responsive to a change in price. That could make a price increase unprofitable or even result in losses (as well as precipitate a further decline in the market).

5.1.5 Notwithstanding the fact that **Royal Mail may be constrained in its ability to increase prices,** it should be noted that any increase in price (without any efficiency gains or improved service) would represent a transfer from customers to Royal Mail with no net gain to the economy[11]. This indicates that simply increasing prices (without any efficiency gains or improved service) will not necessarily be beneficial to the economy and places more emphasis on the need to reduce costs.

5.1.6 According to the Hooper review, "*without policy changes, financial pressures on Royal Mail will mean that emergency financial support is likely to be needed*"[12]. This implies that, in the absence of government intervention, Royal Mail would continue to decline over time. Resources the company expects to invest in modernisation would still be spent, but with potentially less focus or impact on performance.

5.1.7 Indeed, Postcomm found[13] in the first year of the 2006-10 price control that Royal Mail had significantly underspent both on restructuring costs and on new equipment to modernise. Without investing funds effectively to transform the business, improving efficiency, reducing costs and diversifying and expanding its postal services, the continued ability of Royal Mail to provide a universal postal service is at serious risk. Because the universal service is a legal requirement under European law, not only would

[8] Same as FN6
[9] Figure 15, Page 53 of FN5
[10] Figure 18, page 56 of "Modernise or Decline: policies to maintain the universal postal service in the United Kingdom" 16 December - http://www.berr.gov.uk/files/file49389.pdf
[11] In fact, if a price rise leads to a fall in demand, this can actually lead to a reduction in economic welfare in the short term (known in economic terms as a 'deadweight loss') as the combination of higher prices and lower demand means that some customers who value the good at more than the cost of producing it, but less than the cost of purchasing it, will not consume the good.
[12] Page 64 of FN10
[13] The independent review of the postal services sector: First submission by Postcomm, the industry regulator.

the UK lose the benefits associated with such a service, but it could also face infraction proceedings.

5.1.8 In relation to emergency financial support, the Hooper review acknowledged that "*because no other company is currently able to provide the universal service, there would be strong policy reasons for the Government to meet such a request*"[14]. Owing to the requirements of restructuring aid, Hooper also noted that the implications could include accelerated rationalisation; the sale of (profit-making) subsidiaries; and compensatory measures to benefit competitors.

5.1.9 One could argue that Government intervention (at a later date) to provide some sort of emergency financial support represents the true 'counterfactual'. Since we do not know what such a scenario would involve (and the possibilities could vary significantly), it is not feasible to use this as a baseline or a basis for comparing other options. For the purpose of this impact assessment, therefore, the 'do nothing' option is no further government intervention in any form.

5.1.10 Although it is not possible to estimate what the provision of a subsidy at a later date would involve, it is very likely that the costs would be higher than those associated with the proposed package of measures, and very likely that the benefits would be correspondingly lower. Providing such a subsidy would not address the fundamental problems Royal Mail currently faces; nor would it achieve the objectives set out in the Hooper review. In this sense, the proposed package of measures can be seen to 'dominate' the provision of a later subsidy. As a result, subsidy is not considered further in this impact assessment.

5.2 Option 2: Implement the Hooper package - partnership, pensions & regulatory change

<u>Benefits</u>

5.2.1 The Government asked Hooper to consider a number of objectives: "*how to develop a vibrant postal market which can respond quickly to the changing needs of consumers; how to reduce the risks currently facing the taxpayer; and most important, how to maintain the universal service*"[15]. In order to achieve these objectives, the Government proposes to implement a package of measures, which includes: a strategic partnership between Royal Mail and an experienced postal or network company; transferring the historic pension liabilities to Government; and changes to the regulatory framework.

5.2.2 The benefits associated with achievement of these objectives will accrue to the wider economy: to taxpayers as the majority shareholder of the Royal Mail; to those sending mail in terms of an improved service; and to Royal Mail's employees in terms of their future employment. In addition, sustaining the universal postal service will benefit not only those who send mail but also the wider economy.

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[14] Same as FN10

[15] Page 104 of "Modernise or Decline: policies to maintain the universal postal service in the United Kingdom" 16 December - http://www.berr.gov.uk/files/file49389.pdf

Table 1 : Summary of benefits associated with the proposed package of measures

Description of Benefit	Estimated value (PV over 10 yr period)
Benefits of transformation	
1. Sustaining the universal service	Not quantified
2. Increased efficiencies (based on an ultimate saving of £1.2bn in costs p.a.)	£2.6 - £3.0 billion
3. Pension deficit / admin benefits	£6.0 billion (transfer, HMG to Royal Mail) / £190 million
4. Improved labour relations, which reduces the scope for industrial action	Not quantified
5. Improved relations with the regulator, which saves management time	Not quantified
More effective regulation (increased promotion of competition where this is appropriate, possible economies of scale)	Market regulation - not quantified Potential regulator cost savings - £0.9m
Proceeds from sale of minority shareholding	Not quantified
Benefits of diversification and expansion	Not quantified

Sustaining the Universal Postal Service

5.2.3 The Government's first priority is to maintain the universal postal service. It has a number of economic and social benefits, as identified by Hooper[16]:

- "*The national network strengthens social cohesion by ensuring that everyone, whether in urban, rural or remote areas, has an accessible, reliable means of communication and the capacity to send and receive physical goods. It also enables access to other services, such as internet shopping.*
- *"The universal service is important to the UK economy for precisely the same reason: it enables trade. Companies of all sizes rely on the postal service to build their business, supply goods and receive payment.*
- *A uniform tariff protects those who use the postal service rarely or who live in areas of low population density. They might otherwise face a connection charge, higher prices or less convenient services.*

[16] Page 32 of FN17

- *"An affordable service protects the ability of vulnerable consumers and those with lower incomes to send and receive goods, without the need for means testing*".

5.2.4 Only 13% of residential customers are familiar with the concept of the universal postal service, but the public values the individual features which it comprises. In research commissioned by Postcomm[17], 90% of respondents believed that a uniform tariff was very important or fairly important; 82% of residential customers and 73% of businesses said that a six-day service is either important or fairly important; and 82% of residential customers wanted a guaranteed next-day service to be provided. A separate report by Postwatch[18] warns of strong opposition to any move away from uniform pricing.

5.2.5 It is difficult to estimate the value to the wider economy, in monetary terms, from maintaining the universal service. But the research referred to above (supported by evidence submitted directly to the panel during the Hooper review) implies that maintaining the service is of paramount importance to UK citizens and therefore the economy more generally as an enabler of trade.

5.2.6 The Government believes that the package of measures proposed by Hooper should enable Royal Mail to overcome all but one of the constraints (see para 2.1) which currently undermine its ability to respond sufficiently quickly to the declining market and, ultimately, its ability to provide the universal service.

5.2.7 The benefits associated with overcoming each of these constraints is discussed separately below, with the exception of pricing. As discussed above, Royal Mail may be limited in its ability to raise prices owing to the effect this could have on volumes (as customers switch away from post to substitutes such as digital media). This puts more emphasis on reducing the cost base and achieving real efficiencies, thus developing increased margins between costs and prices to allow continuing investment feed back into modernising the business. Notwithstanding the fact that Royal Mail may be limited in its ability to increase prices, a price rise (without any efficiency gains or improved service) would simply represent a transfer from customers to the Royal Mail, with no net gain for the wider economy (unlike the efficiencies associated with cost-savings considered below). Because enabling Royal Mail simply to increase prices would not necessarily result in benefits to the UK, the proposed package of measures focuses on overcoming the remaining four constraints identified by Hooper.

5.2.8 It is also expected that the proposed package will deliver additional benefits including: benefits from Ofcom regulating the sector (including economies of scale); and benefits to customers in terms of increased choice of services that are better suited to their needs. These are discussed in more detail below.

Tackling Efficiency

5.2.9 Hooper recommended *"a strategic partnership between Royal Mail and one or more private-sector companies with demonstrable experience of transforming a major business, ideally a network business, in circumstances comparable to those now faced by Royal Mail"*[19]. Such an injection of skills from a partner should help to enable effective modernisation of Royal Mail more quickly, and ensure that it becomes an efficient, innovative and viable business. Royal Mail started a transformation programme a number of years ago and as the Hooper review makes clear, progress has been very

[17] The Needs of Users of the Postal Service: Customer Service Report, Postcomm 2007
[18] Postal Universal Service Obligation: Value to the Citizen, prepared for Postwatch by Accent 2008
[19] Page 14 of "Modernise or Decline: policies to maintain the universal postal service in the United Kingdom" 16 December - http://www.berr.gov.uk/files/file49389.pdf

slow. As discussed above, postal services are currently in structural decline and falling volumes will further undermine the ability of the company to transform its business in the absence of immediate action by Government.

5.2.10 Hooper said that the process of modernising a company such as Royal Mail can be divided into two distinct phases. The first is 'transformation' which involves improving efficiency and reducing costs. The second is 'diversification and expansion', which could be achieved by: extending the range of services offered; extending the geography covered; or by expanding into related services. This second phase of modernisation will obviously provide benefits (in terms of greater choice and services which more closely reflect customer requirements), but as there is some uncertainty at this stage about what the second phase of modernisation will involve, this impact assessment focuses mainly on the first stage: transformation.

5.2.11 Firstly we need to define the salient counter factual: what are the likely benefits that would be achieved given no further government intervention? These benefits can then be weighed against those forecast to be achieved under the proposed package of measures.

5.2.12 It is impossible to predict the policy of any future partner of Royal Mail in terms of spending on modernisation. This analysis, therefore, is based on Royal Mail's existing spending plans for modernisation.

5.2.13 In the absence of better information, the following benefit analysis assumes that, under the counterfactual, Royal Mail is likely to achieve 20% of the modernisation benefits available. This reflects that the company seemed on course only to achieve 20% (0.6% / 3%) of the price control target for a reduction in costs[20]. By comparison, partnership is likely to enable the potential benefits from modernisation to be realised more fully as the company possesses the scope to go further and faster.

5.2.14 In its submission to the Hooper review, Royal Mail said that it could reduce its cost base by £1.2 billion (this represents around 20% of its current costs). Assuming that Royal Mail can achieve around 20% of the total efficiencies in the absence of intervention, the additional savings associated solely with the proposed package of measures are assumed to be £0.96 billion per annum.

5.2.15 Transformation will take time. These savings would not fully materialise straight away. Modernisation has occurred at varying rates across Europe. Reorganisation in Switzerland, for example, is expected to take four years in total, compared to eight years in Holland and ten years in France and Germany. It could be argued that transformation in the UK would not take as long as ten years: the technology to enable greater automation has already been developed and is commercially available; it is envisaged that any strategic partner will have experience in transforming a major network business; and market forces are exerting considerable pressures to modernise. For the purposes of this assessment, therefore, we assume that transformation will take between five and seven years and that improved efficiency is achieved at a uniform rate over this period.

5.2.16 Based on these assumptions, the present value of increased efficiencies over a ten year period is estimated at between £5 billion and £6 billion. To be conservative, if we assume that only 50% of the total benefits are achieved, the present value of benefits over a ten year period are estimated at **between £2.6 and £3.0 billion**.

[20] In Postcomm's first submission to the Hooper review[20], the regulator said that Royal Mail was forecasting an annual unit cost reduction of 0.6% (2007-8 to 2009 -10). Under the price control, the regulator's target for Royal Mail was set at 3% per annum for the period to 2009-10.

5.2.17 To conclude, our best understanding of the potential value of efficiency savings is derived from Royal Mail's claim that it could reduce its cost base by £1.2 billion, which results in estimated benefits of between £2.6 and £3.0 billion (present value over a ten year period). This estimate illustrates the scale of the efficiencies that would be attributable to the proposed package of measures. But it does not give an indication of how exactly such efficiencies would be achieved. For illustration, we consider three areas where efficiency may be improved, although the information has not been available to estimate, in monetary terms, the scale of the potential efficiencies in each area).

i) Automation

5.2.18 Walk-sorting is the process of sorting letters into groups which correspond to the addresses covered by a postal worker's round. According to the Hooper review, Royal Mail uses machines in its mail centres to sort 70% of letters into walks. Although this is an improvement compared to 50% two years ago, it is still lower than the 95% managed by leading European competitors, indicating that further efficiencies could be achieved by further automation of walk-sorting.

5.2.19 Walk-sequencing is the process of putting the letters in the right order for delivery. At Royal Mail, this process is currently carried out entirely by hand, taking each postal worker 2-3 hours per working day. Royal Mail is in the process of buying and installing machines with the aim of sequencing 75% of letters automatically by 2012-13. This compares to around 85% for the leading European competitors. Again, this implies there are further efficiencies to be achieved by further automation of walk-sequencing.

ii) Working practices

5.2.20 The Hooper review also highlighted a number of working practices which restrict Royal Mail's efficiency[21]:

- *"Early finishes. It has been common practice that postal workers go home when they have finished their round. In the summer or on certain days of the week when volumes are low, this can be up to three hours before their paid hours have ended. If, however, additional time is needed to complete a round, overtime can be claimed or the round not completed.*

- *"Covering for absence. Employees will on occasion not carry out a colleague's deliveries without being paid overtime to do so, even when their own workloads are relatively light. So a postal worker who is paid until 2.00 pm and finishes his or her own route at 11.00 am may still claim overtime to cover a colleague's deliveries, even though they could be completed within paid hours.*

- *"Equipment. In some locations, the CWU has instructed its members not to use new technology (such as machines for sorting larger letters and hand-held devices to track mail) until there is both a national and local agreement about their use.*

- *"Demarcation. Employees in some mail centres have been known to refuse to work in the delivery office, for example, even though both are on the same site".*

iii) On-going pension contributions

[21] Page 51 of "Modernise or Decline: policies to maintain the universal postal service in the United Kingdom" 16 December - http://www.berr.gov.uk/files/file49389.pdf

5.2.21 The Hooper review states that "*at 20% of pensionable pay, the cost of current service contributions is significantly higher than the average for defined benefit schemes of 16.1% and around three times more expensive than schemes based on defined contributions*"[22]. Royal Mail has already made changes to its pension scheme. New employees will be offered a defined contribution scheme; the calculation of benefits for existing members will be based on a career average; and the pensionable age has increased from 60 to 65). Hooper found that "*over the next few years, these changes are expected to reduce Royal Mail's costs associated with current service to levels that are broadly consistent with industry averages*."

5.2.22 With this in min, it is not expected that the proposed package of measures will lead to any additional benefits in terms of ongoing pension contributions, which Royal Mail will continue to fund. The proposed package of measures relates only to the historic liabilities, which is dealt with in the section below.

Pension deficit

5.2.23 As set out in Annex 1, the government is proposing that all assets and liabilities relating to pensions accruals after the publication date of the Hooper Report (16 December 2008) will remain with the Royal Mail Pension Plan (RMPP), along with assets to meet the expected cost of those liabilities. All other liabilities will be transferred to a new pay-as-you-go public sector scheme, with the assets transferred to Government and sold over a number of years. This is the preferred option because it will maximise the economic benefits of the Government's wider proposals for partnership, whilst doing so at the lowest risk and (in the medium term) cost to the taxpayer going forward.

5.2.24 The transfer of historic liabilities and assets from Royal Mail to Government results in a benefit to Royal Mail, which is calculated at Annex 1 to be £6.0Bn[23]. Because there is a corresponding cost to Government and the taxpayer, however, this does not result in any net economic gain or loss because the deficit is no larger or smaller than before the change.

5.2.25 Estimated benefits with a present value of £190m (calculated over a ten year period) will accrue owing to the reduction in investment costs of the RMPP and a reduction in the value of the PPF levy payable by the scheme. A full breakdown of benefits is attached at Annex 1.

Labour relations

5.2.26 A strategic partnership between Royal Mail and a private-sector company will not only bring access to capital and practical experience of transforming a major network business), but it should also help develop more effective relations between the union and the management. The Government is looking for a partner which has a track record of working and communicating with its workforce and their representatives to introduce significant change in a business. The Hooper review noted that industrial relations at Royal Mail were currently "poor" and had been the subject of a previous review by Lord Sawyer in 2001. Hooper found that "*over the past decade, disputes between Royal Mail's management and the Communication Workers' Union have had a major impact on*

[22] Page 52 of "Modernise or Decline: policies to maintain the universal postal service in the United Kingdom" 16 December - http://www.berr.gov.uk/files/file49389.pdf

[23] Although in a recent (19 February 2009) letter from Jane Newell, (Chairman, Royal Mail Pensions Trustees Limited) to Lord Mandelson; it was suggested that the deficit may well be much larger than this latest formal actuarial valuation. Indeed Royal Mail Chief Executive, Adam Crozier, told the BERR select committee (24 February 2009) that the upcoming pension scheme valuation would see this figure rise to 'a deficit of £8 to £9bn'.

the company's ability to implement change and make progress in transforming the business"[24].

5.2.27 Industrial action represents a real cost to the economy in terms of lost production and it can also create uncertainty for customers (which will occur even if action is planned and subsequently cancelled). Industrial action could also have adverse knock-on effects for the postal sector more generally. Hooper referred to evidence that suggests *"some companies using the postal service for transactions and advertising decided to use other media on a permanent basis after strikes in 2007"*[25]. The threat of industrial action alone can lead to delays in driving through plans for modernisation, in automation and pension reforms, for example.

Relationship with the regulator

5.2.28 The relationship between the company and its regulator, Postcomm, is also difficult. The Hooper review commented that "*there is a lack of trust on both sides…these tensions act as a constraint on Royal Mail by diverting management attention from the main task at hand*"[26].

5.2.29 As we do not know the extent of management's time that is diverted away from running the company as a result of the relationship with Postcomm, it is not possible to estimate the potential benefits of improving the relationship between Royal Mail and its regulator. It is clear, however, that strengthening relations with the regulator should enable Royal Mail to focus more fully on modernisation.

More effective regulation of the sector

5.2.30 The Hooper review recommended that Ofcom "*should be appointed to regulate the postal sector, reflecting its connections with the broader communications sector…the regulator needs a new set of tools to regulate the sector: wider reaching regulatory powers, formal market analysis, and a significantly improved understanding of the costs of Royal Mail's business*"[27].

5.2.31 All sectors of the UK economy are subject to regulation to protect consumers. Most sectors are subject to ex post regulation, whereby the competition authorities have powers to tackle anti-competitive practices (abuse of dominance or anti-competitive agreements). Such regulation relies on the application of competition legislation after the anti-competitive behaviour has taken place. Other sectors and sub-sectors are subject to ex ante regulation which aims to stop undesirable behaviour before it takes place. An example of this type of regulation includes the setting of access prices in the postal sector to ensure that Royal Mail's competitors have fair access to the company's infrastructure. Both types of regulation protect consumers (from being charged excessive prices, for example).

5.2.32 Whilst the recommendation to make Ofcom responsible for the regulation of the postal sector in the future is not made from the point of view of cost saving, it is possible that transferring regulatory responsibility to Ofcom could result in some economies of scale. For example, fixed costs associated with running the organisation (such as human

[24] Page 56 of "Modernise or Decline: policies to maintain the universal postal service in the United Kingdom" 16 December - http://www.berr.gov.uk/files/file49389.pdf
[25] Page 57 of FN31
[26] Page 58 of FN31
[27] Page 87 of "Modernise or Decline: policies to maintain the universal postal service in the United Kingdom" 16 December - http://www.berr.gov.uk/files/file49389.pdf

resources and facilities management) will be spread over a larger workforce. Ofcom currently has 850 staff compared to around 70 at Postcomm, whose 2007/08 Annual Report[28] forecasts outturn spend of £9.2m.

5.2.33 As a larger organisation, Ofcom should benefit from economies of scale (although it is difficult to estimate the exact size of such economies at present). It should be able to offer a broad range of opportunities for its staff, and can also attract and develop deeper expertise on particular aspects of regulation. As a regulator with a wide range of responsibilities, it can be more efficient in allocating resources to meet the most difficult and time-consuming aspects of its work, such as price control negotiations. Should the approximate 10% operating cost reduction achieved in creating Ofcom compared to its previous constituent parts[29] also apply to Postcomm's current spending, there is a potential saving of approximately £0.9 million per annum.

5.2.34 Ofcom is partly funded by the sectors and operators it represents. This will extend to post once Ofcom has responsibility for this sector too. Previously, Postcomm has been funded predominantly by Royal Mail, with a small amount received in licence fees. So even in the absence of any economies of scale, Royal Mail should make a saving in terms of its contribution to the running costs of its regulator, as other postal service providers will also now contribute.

5.2.35 Hooper made it clear that Ofcom's primary duty in relation to postal services should be to ensure provision of the universal postal service. If Ofcom were to conduct a formal market analysis to determine the extent to which Royal Mail has market power in each segment, it could design a regulatory regime that focuses ex ante regulation on those areas where Royal Mail exhibits dominance. Greater competition will bring benefits to consumers in the form of lower prices (if prices were above competitive levels previously), improved quality and/or greater choice. It is not possible to quantify these benefits.

5.2.36 Ofcom has concurrent competition law powers and there would be benefits if such powers could be applied to wider postal services sector. According to the Hooper review there would be benefits for Royal Mail because "*competition law powers would remove a barrier to future deregulation. The regulator is better equipped to remove products and services from the ex ante price control if it has the assurance that it can take suitable action in the case of a dominant company abusing its market power*"[30]. Over time, this deregulation would reduce the bureaucratic burden not only on Royal Mail, but the sector more widely.

5.2.37 An improved understanding of costs would also bring benefits as set out in the Hooper review. It would provide information to enable more effective management of the company; it would enable more effective regulation of the sector; and it would also ensure that access prices are not uncompetitive.

5.2.38 The wholesale access price is the price paid to Royal Mail by its competitors who collect, sort and transport mail before injecting their mail into Royal Mail's network for delivery over the 'final mile'. Under the current price control, Postcomm requires that there must be a fixed 'headroom' between a set of access prices and their Royal Mail "reference" retail prices. If the headroom is too high, it could encourage inefficient entry for some

[28] http://www.psc.gov.uk/postcomm/live/about-postcomm/annual-reports-and-plans/postcomm-annual-report-2007-08/Pcomm_AnnRep_0708_AW6.pdf
[29] The NAO report, The Creation of OFCOM: Wider lessons for public sector mergers of regulatory agencies – Table 14,
[30] Page 92 of "Modernise or Decline: policies to maintain the universal postal service in the United Kingdom" 16 December - http://www.berr.gov.uk/files/file49389.pdf

products. If it is too low, it could discourage efficient entry for other products. Only if the headroom is directly related to the costs which Royal Mail incurs when collecting, sorting and transporting mail will it encourage efficient entry, bringing benefits for consumers. At present, it is disputed which is the case and Hooper recommends that this is an area that Ofcom should investigate as a priority.

Proceeds from sale of minority shareholding

5.2.39 A strategic partnership with a private-sector company with experience of transforming its business will enable Royal Mail to deliver efficiencies, to focus on customer needs, and to respond quickly to opportunities arising from the changing dynamics of the communications sector. The creation of a strategic partnership will also result in an injection of private sector capital (the purchase price of the minority shareholding). This could just represent a transfer from the private sector. If such an injection comes from overseas, however, this could represent a net benefit to the UK economy. At this stage we do not know the potential purchase price of a minority shareholding and are therefore unable to quantify this potential impact.

Longer terms benefits of diversification and expansion

5.2.40 As mentioned above, the Hooper review identifies two stages of modernisation: transformation (improving efficiency and reducing costs); and diversification and expansion (finding new sources of revenue). There is currently a high degree of uncertainty about the form which diversification and expansion may take. For that reason, this impact assessment focuses on the impacts associated with transformation.

5.2.41 Even so, it should be noted that the second phase of modernisation is crucial to the long term sustainability of Royal Mail. Although the exact benefits are difficult to predict and impossible to quantify at this stage, they will come in the form of: benefits to customers (from the provision of services which more closely reflect their needs and requirements); benefits to the taxpayer (as majority shareholder of a company that is innovative and exploits opportunities associated with the changing dynamics of the market); and benefits to employees of Royal Mail (in terms of their future employment).

Costs

5.2.42 Table 2 summarises the costs associated with the proposed package of measures. Each cost is explained in more detail in the sections below.

Table 2: Summary of costs associated with the proposed package of measures

Description of Cost	Estimated value (PV over 10 yr period)
Transformation	
1. Financial costs of transforming the network	No additional spend planned
2. Staff time	£8-11 million
3. Costs associated with changing regulators	Not quantified
4. Pension deficit / admin costs	£6.0 billion (transfer, Royal Mail to HMG) / £205 million
5. Foregone minority shareholding	Not quantified
Diversification and expansion	Not quantified

Financial costs of transforming the postal network

5.2.43 Restructuring Royal Mail's national network of mail centres, distribution centres and delivery offices will require investment and staff time. Royal Mail is already expecting to invest significantly in new machinery and improved facilities over the next five years.

5.2.44 In the absence of intervention, it is possible that some of this money is diverted to keeping the company afloat (by funding increased deficit recovery payments for example); and this money is spent less effectively without the experience of transformation which a private-sector company can provide. As a result, there are not expected to be any additional costs associated with modernisation under the proposed package of measures.

Loss of minority shareholding in Royal Mail

5.2.45 The Government proposes to sell a minority stake in Royal Mail. The price which a strategic partner will be willing to pay depends on its expectations of future Royal Mail returns with respect to the minority shareholding. The partner's discounted cash flow/profitability valuation will need to take into account future sector prospects and the influence on Royal Mail's efficiency which the partner will help drive.

5.2.46 With this in mind, it could be argued that a 100% Government shareholding in Royal Mail (in the case of no intervention) would not be worth the same as the combined value of a majority Government shareholding plus a minority private sector shareholding. This is because the value of the shares depends crucially on the success of the proposed package of measures (including a strategic partner) to transform Royal Mail into a viable and more successful business.

5.2.47 In other words, a 100% shareholding of the current Royal Mail may be worth no more than a majority shareholding of the modern, efficient Royal Mail which the Government believes the proposed package of measures will achieve. In this sense, the taxpayer may not be losing anything by selling a minority shareholding in Royal Mail to a strategic partner, since the strategic partner will play a crucial role in modernising the business.

Investment of staff time required

5.2.48 The Hooper review compared the management challenge of modernising Royal Mail to that of "*modernising the telecommunications trunk network by BT in the 1980's. Consultation with staff, planning for the transition to a new network structure, and the adaptation of working patterns demand a major investment of time and expertise at all levels of the organisation*"[31].

5.2.49 It is likely that a significant amount of management time will be dedicated to modernisation over the next few years. In 2007-08, Directors' annual salaries and fees at the Group level were worth £1.822 million[32]. If we assume that all their time is dedicated to modernisation over the next 5 to 7 years, the present value of this is estimated at **between £8 and £11 million**.

5.2.50 In the absence of intervention, a proportion of staff time will be dedicated to modernisation. Unless relationships with the Union and regulator are improved, however, it is likely that a significant portion of management time would be diverted away from modernisation activities towards day-to-day management activities with the intention of keeping the company afloat in the face of declining postal volumes and higher deficit recovery payments.

5.2.51 It is possible that the proposed package of measures could result in additional staff time being dedicated to modernisation activities at other levels of the organisation, meaning that the figures given above would be an underestimate.

Costs associated with transferring regulatory responsibility to Ofcom

5.2.52 Expanding Ofcom's remit to include the postal sector could result in economies of scale over time, but there will inevitably be some one-off costs associated with transferring responsibility in the short term. Such costs include training staff moving to Ofcom and amalgamating systems. The NAO report, *The Creation of OFCOM: Wider lessons for public sector mergers of regulatory agencies*[33], considers the costs associated with setting up a new regulator by merging five entities. So it is difficult to draw meaningful one-off cost parallels with the planned regulatory transformation in the case of the postal sector.

Costs associated with new pension arrangements

5.2.53 The transfer of historic liabilities and assets from Royal Mail to Government results in a cost to Government, calculated at Annex 1 to be £6.0Bn. Because there is a corresponding benefit to Royal Mail, however, this does not result in any net economic gain or loss because the deficit is no larger or smaller than before the change. In addition, the Government will assume certain risks currently carried by the scheme (and ultimately Royal Mail), including longevity risk in respect of the transferred liabilities.

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[31] Page 73 of "Modernise or Decline: policies to maintain the universal postal service in the United Kingdom" 16 December - http://www.berr.gov.uk/files/file49389.pdf
[32] Royal Mail's annual report 2007-08.
[33]http://www.nao.org.uk/publications/0506/the_creation_of_OFCOM_wider_l.aspx

5.2.54 In addition, estimated costs with a present value of £205M (calculated over a ten-year period) will be incurred owing to the costs of implementation, administration, and the disposal of the scheme's assets that are transferred to Government. A full breakdown of the costs and risks is attached at Annex 1.

The longer term benefits of diversification and expansion

5.2.55 The second phase of modernisation will similarly involve capital expenditure. As discussed above, there is currently a high degree of uncertainty about the form which diversification and expansion may take. For this reason, the impact assessment focuses on the impacts associated with transformation.

6. Risks

6.1 The Hooper Review recommendations are interlinked and form a coherent package. If implemented together, they are capable of bringing about the structural changes needed to ensure a sustainable future for the Royal Mail. None of the three main elements will be sufficient on its own. Implementing only one or two of the recommendations will not enable Royal Mail to modernise and will leave the universal service under threat.

6.2 The regulatory risks centre on the regulator's primary duty to secure the provision of the universal postal service, balanced with its need to set price controls and regulate competition. If incorrectly administered, consumers could be charged higher prices than necessary or, conversely, Royal Mail may be placed under a greater financial strain than is desirable. This risk is intended to be mitigated by the appointment of Ofcom and the new regulatory framework. Ofcom has successfully managed regulation in the telecommunications sector during a period of significant market change, and has experience of concurrent competition law powers. The bill requires Ofcom to carry out a market analysis, provides powers to encourage greater cost transparency and enables Ofcom to require other postal companies to contribute towards the cost of the universal service if, after modernisation, it appears that the burden on Royal Mail is unfair. The bill also provides a route of appeal to the Competition Commission for price control decisions.

6.3 The transfer of the pension deficit will be subject to scrutiny by the European Commission under the rules on state aid. The Government is already in discussions with the Commission. The Government believes that it can put forward a robust case for taking on the pension liabilities as part of a package of measures which include a strategic partnership.

6.4 Partnership risk is two-fold. Firstly, there can be no guarantee that a partner willing to invest at an appropriate value will be found, whether because of concerns about regulatory certainty or because of challenging global market conditions. Secondly, there is a risk that a partner may not meet the expected target improvements in the business. The Government has employed UBS to help identify and approach potential partners and to ensure that there is a competitive field from which to select a partner in an open process. Uncertainty about the detail of regulation will be minimised through contact between the partner and Ofcom which will be able to demonstrate its achievements in regulating the UK's telecommunications sector. The Government is seeking a partner with a proven track record in transforming a major network or postal business to enhance the prospects for successful modernisation of Royal Mail and to reduce the current risk that the company will not meet its transformation targets.

6.5 Even if the Government's proposals are implemented fully, there is a risk that mail volumes will decline at a faster rate than is currently forecast. But this risk would be greater if the "do nothing" option were followed. It is mitigated by the Hooper proposals which are designed to drive transformation at a faster pace.

6.6 Further industrial action will delay the modernisation of Royal Mail and will exacerbate the decline in mail volumes. The Government is seeking a partner with a track record of working constructively with the workforce and their representatives in managing a substantial programme of change. .

7. Enforcement

7.1 The regulatory proposal seeks to abolish the regulator Postcomm, and make Ofcom responsible for the regulation of the postal sector in the future. Ofcom already has a duty to perform its functions in line with the five principles of better regulation which state that any regulation should be transparent, accountable, proportionate, consistent and targeted only at cases where action is needed.

7.2 BERR's Better Regulation Executive already works towards using targeted measures to simplify and improve existing regulation. This includes communicating more clearly with businesses to help them understand what they must do to comply; carefully assessing the impact of any new regulations; and working with the EU to improve European guidelines. The merger of Postcomm with Ofcom meets with the overarching aim of simplifying and improving existing regulation since it will lead to a reduction in the overall number of regulatory bodies and the new regime brings the prospect of deregulation over time.

7.3 The regulatory proposals are also in line with the Hampton Review[34] which considered how to reduce unnecessary administration for businesses without compromising the UK's excellent regulatory regime.

7.4 As well as having a duty to perform in line with the five principles of better regulation, Ofcom has its own regulatory principles. Ofcom will:

- regulate with a clearly articulated and publicly reviewed annual plan, with stated policy objectives.
- intervene where there is a specific statutory duty to work towards a public policy goal which markets alone cannot achieve.
- operate with a bias against intervention, but with a willingness to intervene firmly, promptly and effectively where required.
- strive to ensure its interventions will be evidence-based, proportionate, consistent, accountable and transparent in both deliberation and outcome.
- always seek the least intrusive regulatory mechanisms to achieve its policy objectives.
- research markets constantly and will aim to remain at the forefront of technological understanding.
- consult widely with all relevant stakeholders and assess the impact of regulatory action before imposing regulation upon a market.

7.5 The Macrory Review[35] makes a number of recommendations to ensure that regulators have access to a flexible set of sanctioning tools which are modern, fit for purpose, and

[34] "Reducing administrative burdens: effective inspection and enforcement", March 2005 - http://www.berr.gov.uk/files/file22988.pdf

consistent with a risk-based approach to enforcement outlined by the Hampton Review. The Hooper Review acknowledged that, in regulating the postal sector, Ofcom would need to adopt a risk-based approach to protection of the universal service, particularly given the inherent uncertainty of the market. This would involve planning a regulatory response to a broad range of scenarios, from the rapid development of end-to-end competition, to a more limited increase in the number of companies providing upstream services. Ofcom will also need to plan for the market to decline at various rates, particularly as the combination of cyclical and structural change makes volumes more difficult to predict.

7.6 Extending Ofcom's existing concurrent competition law powers to include post will help with this risk-based approach by giving the regulator a more powerful set of tools with which to investigate anti-competitive behaviour, should the need arise. This should bring benefits to the sector as a whole, and should also reduce the need to micro-regulate Royal Mail.

8. Recommendation and summary table of benefits and costs

8.1 Based on the evidence given in section 5, the Government's preferred option is the package of measures recommended by the Hooper Review: strategic partnership between Royal Mail and a private sector company; transferring Royal Mail's historic pension liability to Government; and changes to the regulatory framework, including transferring responsibility for the postal services sector from Postcomm to Ofcom.

8.2 Summary table of costs and benefits:

Benefits	
Description of Benefit	**Estimated value (PV over 10 year period)**
Benefits of transformation	
Sustaining the universal service	Not quantified
Increased efficiencies (based on an ultimate saving of £1.2bn in costs p.a.)	£2.6 - £3.0 billion
Pension deficit / admin benefits	£6.0 billion (transfer, HMG to Royal Mail) / £190 million
Improved labour relations, which reduces the scope for industrial action	Not quantified
Improved relations with the regulator, which saves management time	Not quantified
More effective regulation (increased promotion of competition where this is appropriate, possible economies of scale)	Market regulation - not quantified Potential regulator cost savings -

[35] "Regulatory Justice: Making Sanctions Effective" – November 2006 - http://www.berr.gov.uk/files/file44593.pdf

	£0.9m
Proceeds from sale of minority shareholding	Not quantified
Benefits of diversification and expansion	Not quantified
Costs	
Description of Cost	**Estimated value (PV over 10 year period)**
Transformation	
Financial costs of transforming the network	No additional spend planned
Staff time	£8-11 million
Costs associated with merging regulators	Not quantified
Pension deficit / admin costs	£6.0 billion (transfer, Royal Mail to HMG) / £205 million
Foregone minority shareholding	Not quantified
Diversification and expansion	Not quantified

9. Implementation

9.1 The Postal Services Bill 2009 gives effect to the Government's chosen policy option.

9.2 The Bill will provide for the transfer of regulatory responsibility for the postal services sector to Ofcom. It will specify Ofcom's primary duty in relation to the postal sector will be to maintain the universal service, and bring into force new and wider-ranging regulatory powers.

9.3 The Bill will provide for the creation of a new pension scheme into which the historic liabilities and a proportion of the assets of the Royal Mail Pension Plan will be transferred. Government will work closely with the Royal Mail Pension Plan Trustee when making of Orders under this part of the Bill.

9.4 Legislation alone will not be sufficient to secure a strategic partner for Royal Mail. In parallel with the Bill's passage through Parliament, the Government is conducting a commercial process to identify potential partners and take initial steps towards an agreement under which a minority shareholding might be sold, subject to the bill achieving Royal Assent.

9.5 Given the urgency, the Government intends to press on with the proposed package of measures as soon as possible after Royal Assent. Finalisation of new arrangements will be subject to obtaining state aid and competition clearance from the European Commission. This is unlikely before early 2010.

9.6 In an already declining market and with revenues threatened further by the impact of the global economic downturn, Royal Mail needs a strategic partner now more than ever. Taken as a whole, the package of measures will make a real difference to the company's ability to create a sustainable future for its employees and deliver better services to customers.

9.7 We are confident that the recommendations are the right steps to take and legislation will enable the Government to implement them.

10. Monitoring and evaluation

10.1 Royal Mail will remain in public ownership. Through the Shareholder Executive, it will monitor the company's performance and the pace of modernisation. Ofcom will be required to regulate the sector in a manner which it considers will secure the provision of a universal postal service in the UK. Ofcom itself will be monitored by Parliament. It will provide an annual report to Parliament on its responsibilities in ensuring the provision of the universal service and can be called to appear before the BERR select committee.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	***Results in Evidence Base?***	***Results annexed?***
Competition Assessment	No	Yes
Small Firms Impact Test	No	Yes
Legal Aid	No	Yes
Sustainable Development	No	Yes
Carbon Assessment	No	Yes
Other Environment	No	Yes
Health Impact Assessment	No	Yes
Race Equality	No	Yes
Disability Equality	No	Yes
Gender Equality	No	Yes
Human Rights	No	Yes
Rural Proofing	No	Yes

Annexes

Annex 1: Pensions

Postal Services Bill Impact Assessment – Annex on Pensions

This Annex provides a summary of the options, costs and benefits in respect of the proposed measures on pensions set out in the main Impact Assessment

Policy Objective

1. As set out in the main Impact Assessment, the principal objective of the proposed measures is, in the context of a partnership for Royal Mail, to help provide the conditions in which the modernisation of the company can be accelerated, enabling efficiency to be improved, and the delivery of the universal service to be secured going forward for the benefit of all consumers. Tackling the pension deficit enables the company to reap the benefits of modernisation. The pension deficit is a barrier to external investment by a strategic partner and therefore Government regards action to address the historic pension liabilities as essential to achieving modernisation of Royal Mail. Tackling the pension deficit on its own would not be sufficient to achieve modernisation and would not represent value for the taxpayer.

Background

2. Royal Mail is the sponsoring employer of three UK occupational pensions schemes : the Royal Mail Pension Plan (RMPP), the Royal Mail Senior Executive Pension Plan, and the Royal Mail Retirement Savings Plan. These proposals concern only the RMPP. No changes are proposed in respect of the other two schemes.

3. The Royal Mail Pension Plan (RMPP) is a private sector trust-based occupational pension scheme which provides pensions and other benefits to members. The Royal Mail Group Ltd is the principal employer participating in the plan. The RMPP is contracted-out of the State Second Pension and is a registered scheme for tax purposes under part IV of the Finance Act 2004.

4. Royal Mail, with the agreement of the Trustee and after consultation with its employees, has recently changed the benefits the plan provides for service from April 2008. The RMPP was closed to new members from 31 March 2008 and employee members' pension changed from Final Salary to Career Salary Defined Benefit for service from 1 April 2008. In April 2010, the normal retirement age will change from 60 to 65, for service from that date.

5. The total membership of the RMPP as at 31 March 2008 was 452,131. This comprised 161,078 employee members, 177,757 pensioner members, and 113,296 members with preserved rights – principally former employees of Royal Mail who have yet to reach retirement age. The active members comprise employees working in Royal Mail Group's main UK businesses : Royal Mail Letters, Post Office Limited, Parcelforce Worldwide, Romec and Quadrant.

6. The last formal actuarial valuation of RMPP was made as at 31 March 2006, and annual funding updates have been made as at 31 March 2007 and as at 31 March 2008. The value of assets and accrued liabilities as reported in the relevant annual reports and accounts of the RMPP is set out in Table One, below.

Table One : Funding Position of the Scheme (Actuarial Basis)

Actuarial funding basis	31 Mar 2006	31 Mar 2007	31 Mar 2008
	£ bn	£ bn	£ bn
Market value of assets	21.9	23.5	23.7
Technical provisions for accrued liabilities	25.3	26.0	29.6
Surplus (deficit)	(3.4)	(2.5)	(5.9)
Funding level	86.7%	90.2%	80.0%

Source : Annual Report and Accounts of the Royal Mail Pension Plan, 2006-07 & 2007-08

7. The next formal actuarial valuation of RMPP will be based on the funding position as at 31 March 2009. Although the funding level in the scheme is volatile year on year, Government expects that that the deficit will have worsened since 31 March 2008. The Government hopes, with the co-operation of the Trustees, to be able to provide an update on the funding position as at 31 March 2009 soon after that date.

Benefits

8. The principal economic benefit of the proposals is to enable a partnership between Royal Mail and a private sector partner that will accelerate the modernisation of company. These benefits are described and quantified in the main body of the Impact Assessment.

Options – Costs and Risks

9. In developing its proposed measures, the Government's approach has been to find a solution that will enable the required benefits at the best value for money to taxpayers. In addition, the Government has considered the need for approval from the European Commission for any measures under state aid rules[36].

10. The two key considerations are : -

(a) the proportion of the scheme's assets and historic liabilities remaining with the company-backed pension scheme

(b) the practical mechanism chosen for any new, Government-backed arrangements

Proportion of liabilities and assets remaining with the company-backed scheme

11. The transfer of historic liabilities and assets from Royal Mail to Government results in a benefit to Royal Mail, and a cost to Government (and the taxpayer). This does not result in any net economic gain or loss because the deficit is no larger or smaller than before the change. The net economic impact attributable to the policy proposals in terms of this aspect of the proposal is therefore nil.

[36] As the proposed measures will constitute an aid to Royal Mail, they will require clearance from the European Commission. The Commission's decision will only be made after it receives a notification of the proposals, and has carried out a formal investigation. This process has not yet taken place; however the proposed measures have been informed by preliminary discussions with the Commission at official level.

12. Nevertheless, in making the transfer to Government, it is important that the option adopted can be demonstrated to deliver value for money, both in terms of costs to the taxpayer, and risks. In accordance with this objective, the Government's proposal is that all liabilities relating to accruals after the publication date of the Hooper report (16 December 2008) should remain with company backed-scheme. Sufficient assets will be left with the company-backed scheme to meet the expected cost of those liabilities and all other assets and liabilities transferred to Government. In addition, the company-backed arrangements will meet any liability in respect of the final salary link where that exceeds the liabilities provided for in the Government-backed arrangements (i.e. normal revaluation of the preserved benefits under the scheme rules).

13. Table Two below sets out the impact of the Government's proposal in terms of the forecast distribution of assets and liabilities as at 31 March 2010, the assumed date of implementation of any new arrangements. This forecast is an extrapolation from the last actuarial valuation of the scheme as at 31 March 2008, using the assumptions on which that valuation was based. It does not include the effect of subsequent market changes to asset prices or investment yields.

Table Two : Forecast Distribution of Assets and Liabilities

Option	Company-backed scheme		New, government-backed arrangements	
	Liabilities[37] £bn	Assets £bn	Liabilities £bn	Assets £bn
Current[38]	32.5	26.5	-	-
Proposed	3.0	3.0	29.5	23.5

Source : Deloitte / GAD Estimates

14. The Government's proposed option represents the minimum level of liabilities that can be assumed by the taxpayer compatible with ensuring that Royal Mail is left with a scheme that gives rise to an acceptable level of risk for the company, and does not represent a threat to its financial stability going forward. It is also the minimum that is compatible with achieving modernisation through partnership.

Choice of Mechanism

15. The options set out below describe the different mechanisms through which the historic pensions liabilities could be addressed.

A One off payment from Government to the scheme to make good any deficit; but no further changes to the distribution of assets and liabilities in the scheme

B Relevant liabilities and assets transferred to separate scheme (or a separate section of the existing scheme), with Government issuing a guarantee in respect of those liabilities, and assuming the role of the sponsoring employer – including making payments to the scheme to make good any deficit

[37] Liabilities calculated on an actuarial (technical provisions) basis
[38] Estimates as at 31 March 2010, based on extrapolation of the scheme funding position as at the date of the last annual funding update (31 March 2008).

C Relevant liabilities are transferred to Government and met through the establishment of a new, pay-as-you go public sector scheme. Assets transferred to government are in due course sold over a number of years

16. Based on the March 2008 valuation of the scheme, Option A would result in an estimated payment by government of £6 bn to the scheme. But even if it was fully funded on the actuarial funding basis, the scheme would still be of a size that would give rise to significant ongoing volatility disproportionate to the size of the company. We do not consider that this option is compatible with our objective of modernisation through partnership, and would therefore represent poor value for money. The following analysis therefore focuses on the remaining options (B and C) only.

Analysis of Risks

17. Options B and C will involve a transfer of risk between the stakeholders, including to the Government. There are potential risks in the following areas:

- longevity;
- investment;
- inflation;
- implementation
- moral hazard risk or incentive risk

The following paragraphs compare options B and C in terms of these risks.

18 Longevity: If the pension scheme members, or their surviving dependents, live longer than expected the costs of paying their pensions will increase. Government would bear the extra costs in respect of the liabilities transferred to new Government-backed arrangements under both options B and C. The value of the liabilities in Tables One and Two is calculated using the mortality assumption adopted by the RMPP Trustees at the last formal actuarial valuation. This assumption is in line with the mortality assumptions adopted by the vast majority of pension schemes for such valuations[39].

19 Investment: If a fund of assets is used on a long term basis to back the liabilities in the new Government-backed arrangements (as under Option B) and the investment performance of these assets is worse than expected then the costs to the Government will increase.

20. Investment returns can be very volatile: in 2007/08 the scheme's investment return was 1.3%; in 2006/07 it was 7.3%. The value of the liabilities in Tables One and Two above are calculated using the investment returns assumed by the RMPP Trustees at the last formal actuarial valuation, with suitable adjustments to take account of market conditions as at 31 March 2008. However if investment returns were 1% lower than assumed by the Trustees, the deficit assumed by government under Option C would double, increasing from an estimated £6.0 bn to £12.0 bn. Conversely, if investment returns were higher there would be an equivalent reduction in the deficit.

21. The very substantial size of the downside risk to government demonstrates the significance of the investment risk assumed by government under Option B. Because the new Government-backed arrangements would guarantee to provide the benefits to members regardless of investment performance, government (and the taxpayer) would bear the full investment risk. There would be no risk sharing between government and members of the

[39] *Scheme funding: An analysis of recovery plans and clearance applications*, The Pensions Regulator, December 2008, Table 3.3.2b page 39. http://www.thepensionsregulator.gov.uk/pdf/SchemeFundingAnalysis2008.pdf

scheme. In the light of the very significant additional costs that could result from poor investment performance, the government does not feel that taking on investment risk under Option B would represent value for money for the taxpayer.

22. Under Option C government is not exposed to investment risk once the implementation of the new arrangements has been completed. This is consistent with the position in other public sector pension schemes, where historically government has taken the view that the best way to fund public service pension schemes is on a pay-as-you go basis rather than government taking investment risk with taxpayer's money. The public service pension schemes for the Civil Service, Teachers, the NHS, the Police, Fire Service and the Armed Forces all operate in this way and have done so for many decades.

23. Inflation: The benefits payable from the new Government-backed arrangement increase in line with inflation (as measured by the Retail Prices Index), or in line with inflation up to a maximum limit. If inflation is higher than expected the costs of paying these benefits would increase and government would bear the extra costs under both Options B and C. The value of the liabilities in Tables One and Two above is calculated using the inflation assumption adopted by the RMPP Trustees at the last formal actuarial valuation, with suitable adjustments to take account of market conditions as at 31 March 2008.

24 Implementation risk: The implementation of a new Government-backed arrangement carries risks: the liabilities and assets will need to be segregated, appropriate benefit payment systems will be required, the changes will need to be communicated to members, etc. It is important that this implementation is well-managed. Although the implementation risks could be significant they are not a key factor in differentiating between the options.

25 Moral hazard risk or incentive risk: Moral hazard risk occurs where 'perverse' incentives exist so that one party is incentivised to act in way which other parties would consider to be inappropriate. Option B carries the risk of creating moral hazard. The Government would be exposed to investment risk on the scheme's assets, but the investment policy would be set by the Trustee. The Trustee would also have some control over the expenditure from the Government-backed scheme but, because there was a Government guarantee, incentives on the Trustee to minimise risks and control costs would be weakened. Option C avoids the potential moral hazard because the scheme is controlled by the Secretary of State and would be subject to Parliamentary scrutiny. This provides an appropriate balance between the legitimate interests of the members of the new Government-backed arrangement and those of the taxpayer.

26. This analysis demonstrates that in terms of risks, Option C is more significantly more attractive than Option B. It provides a much lower risk option for government and for taxpayers because there is no exposure to investment risk after implementation and no moral hazard / incentive risk.

Analysis of costs and benefits

27. For completeness, we have also compared the estimated costs and benefits Option B and C in Table Three below. This comparison is limited to the incremental costs and benefits of both options in terms of implementation and administration. It does not include a quantification of the risks described above. The potential scale of the risks described above – particularly in relation to investment risk, which could amount to several billion pounds – means that in practice these are likely to outweigh any difference in administrative costs.

Table Three : Comparison of costs and benefits options B and C

Option	B- Funded Scheme (or section), with guarantee	C – Pay-as-you-go public sector scheme
Costs	£m	£m
One off implementation costs - administration and professional advice - disposal of assets	 11 Nil	 11[40] 200[41]
Increase in annual recurring costs - scheme administration	 2	 2[42]
Benefits	£m	£m
Decrease in annual recurring costs - reduction in scheme investment costs - saving on PPF levy	 Nil 8	 20[43] 8[44]

28. This comparison demonstrates that the up-front costs associated with C (the pay-as-you-go mechanism) are higher than B, due to the cost of disposal of the assets transferred to Government. However over time, these are offset by the ongoing saving in annual investment costs due to the much lower level of assets held by the company-backed scheme. The effect of these savings is demonstrated by the summary of the net present value of costs and benefits for the two options, in Table Four below.

Table Four : Net Present Value of costs and benefits under options B and C

Option	B- Funded Scheme (or section), with guarantee	C – Pay-as-you go public sector scheme
Net Present Value – measured over 10 years	£m[45]	£m
Total Costs Total Benefits Net Benefits	25 50 25	205 190 (15)
Net Present Value – measured over 20 years	£m	£m
Total Costs Total Benefits Net Benefits	35 90 55	215 350 135

29. Table Four demonstrates that in terms of the costs and benefits associated with implementation and administration of the new arrangements, the net benefits associated with

[40] Source : Deloitte estimate of overall administrative cost of changes to RMPP and (as applicable) establishment of new scheme, including legal / actuarial advice for all parties
[41] Source : UBS estimate. Cost of disposal averages 1% of asset values based on current asset mix, excluding property
[42] Source : Deloitte estimate based on discussions with Royal Mail. Current scheme administration costs £7-£10M per annum. Increases in total scheme administration costs have been assumed due to additional complexity. It is intended that costs should be minimised through linking administrative arrangements closely to existing scheme arrangements.
[43] Source : Deloitte estimate. Annual saving of £20M against current scheme investment costs of £30M due to fall in the size of the assets held by the scheme
[44] Source : PPF Estimate
[45] Estimates rounded to nearest £5m

the C are significantly higher when measured over a 20 year period. These support the Government's choice of Option C as its preferred approach, although the potential scale of the risks described above – particularly in relation to investment risk – are in practice a much more significant factor..

<u>Conclusion</u>

30. The Government's preferred option for pensions is, in the context of a partnership transaction :-

- In terms of the distribution of assets and liabilities, for all assets and liabilities relating to accruals after the publication date of the Hooper report (16 December 2008) to remain with the RMPP along with assets to meet the expected cost of those liabilities, with all other liabilities and assets transferred to new Government-backed arrangements; and

- In terms of the mechanism to be adopted for the Government-backed arrangements, the liabilities to be transferred to a new pay-as-you go public sector scheme, with the assets transferred to Government and sold off over a number of years.

31. This is the preferred option because it will help ensure financial stability for the company in future, and maximise the economic benefits of the Government's wider proposals for partnership, whilst doing so at the lowest risk and overall cost to the taxpayer going forward.

Postal Services Bill Impact Assessment – Specific Impact Tests

Competition Assessment

1. Since 2001, the UK has been active in promoting effective competition within the postal sector where appropriate, whilst maintaining the provision of a universal service at an affordable and uniform tariff.

2. In addition to Royal Mail, there are currently 21 licensed postal service companies in the UK. Competition has led to 39% of bulk business sent mail being collected, sorted and transported by companies other than Royal Mail. Competitors have taken a fifth of the upstream market. This represents a 2% reduction in Royal Mail's letters revenues, owing to the charges which Royal Mail's competitors must pay for the delivery of letters over the "final mile".

3. The package of measures explained in this Impact Assessment have the potential to make a significant impact on the conditions for and nature of competition within the postal services market, and possibly more widely.

4. The proposal to change the regulator of postal services and to apply competition law as well as ex-ante regulation, where appropriate, has the potential to affect the competitive situation and incentives. So too does the proposal for a strategic partnership.

5. The scope of the potential impact of the proposals for competition are currently unquantifiable, on the basis of existing market analysis. As Hooper notes, there has not yet been a formal analysis of the salient markets within the postal sector. Without an existing understanding of these markets, BERR cannot seek to accurately estimate the impact of the proposals. When it undertakes a market analysis, Ofcom will be mindful of increasing scope for substitution between postal services and the wider communications sector and thus the rate of sector decline driven by e-substitution.

6. It seems likely in the first instance that Royal Mail will continue to possess significant market power / dominance in some aspects of postal services in the UK. Once Ofcom has undertaken a formal analysis of postal services activitiy in the UK, it will be in a position to understand the extent to which Royal Mail has market power in the salient markets.

7. With this understanding, the regulator can design appropriate ex ante regulations and pricing (retail and wholesale/access) controls / regimes to apply to these markets where the incumbent possesses non-transitory significant market power. Such regimes could allow/mandate cost recovery and/or protect the final consumer. They may also be designed to allow access to network elements by competitors as appropriate.

8. Hooper recommends that the existing downstream access regime should be retained but also suggests that, in the light of a market analysis, Ofcom may wish to review access pricing and any implications for competitor network development in the face of "make or buy" decisions.

9. Following a market analysis, certain markets may not require ex ante regulation and could instead rely on existing competition law. Under the Government's proposals, the regulator's powers of investigation would no longer be restricted by Royal Mail's licence.

10. If Royal Mail were to enter into a strategic partnership with one of its existing competitors, the agreement may have the effect of increasing Royal Mail's effective market share in some

markets. If this were the case, EU/UK competition clearance would be needed and certain conditions, such as divestments, might be placed on the transaction.

11. As noted earlier, it is important to assess any likely competition impacts of the proposed package on the universal postal service. Both the Hooper report and BERR considers that increased competition, where appropriate, can help to support the universal service by providing Royal Mail with further incentives to modernise, innovate and to become increasingly efficient. This, in turn , providing more resources to maintain the universal service. Indeed, Hooper notes that *"in its submission to the Review, Royal Mail welcomed competition. It argued that – by accelerating modernisation – the company could finance the universal service from profits in spite of liberalisation and structural decline in the volume of letters."*

Entry Barriers

12. The proposed move from a licensing system towards general authorisations is likely to reduce the cost and marginally increase the speed of market access.

13. Further access price analysis and more transparent accounting systems may increase, rather than reduce, network entry prices. By providing increasing data to the market and by allowing faster and more transparent decisions from the regulator regarding access pricing, future entry barriers may be reduced.

Small Firms

14. The Postal Services Bill aims to secure the future of the universal post service. The universal service is of disproportionate importance to small firms. The Hooper review found that over 50% of small businesses send over three quarters of their bills and invoices through the post. Securing the future of the service will be of significant benefit to these companies.

15. The Postal Services Bill seeks to preserve the universal service in its current form. It does not seek to alter the service in any way. The provisions of the Bill do not apply to small firms (outside the postal sector) directly, nor do they introduce any new costs or administrative burdens on small firms. We do not consider that maintaining the universal service will have any detrimental impact on the current performance or operations of small firms.

16. Changes to an authorisation regime will reduce the administrative hurdle for new postal service companies entering the market. In future, the new general access conditions will allow smaller firms to access not just Royal Mail's infrastructure but that of other providers, allowing more opportunities and greater flexibility.

Sustainable Development

17. The main objectives of the Bill are to secure the long-term future of Royal Mail and the universal service. Intervention is needed to enable Royal Mail to modernise its business in the face of declining volumes of letters owing to structural change in the market and difficult economic conditions. We therefore consider that the Bill supports the principles of sustainable development.

Legal Aid

18. There will be no impact on Legal Aid because the Bill does not create new offences or sanctions for individuals. The Bill will create new powers for the regulator of the postal services sector, but these will apply to postal services providers only.

Environment and Carbon

19. We do not consider that the Bill will have a significant impact on the environment or on greenhouse gas emissions.

20. One of the policy objectives of the Bill is to put in place the conditions to allow Royal Mail to modernise and thrive in the changing communications market. The Hooper Review analysed that changing market and identified green solutions as one possible area of innovation in the postal sector, citing the example of a carbon neutral initiative developed by TNT Post. It is possible that a modernised and more efficient Royal Mail will be better placed to develop such innovative green projects.

Health

21. We do not consider that the Bill will have any impact on health or well-being.

Equality

22. We have looked at each of the equality impact strands individually and have screened the policy against them. We do not believe that there will be any adverse impact on equality. Nor will there be any reduction in existing inequalities.

23. The Bill seeks to preserve the universal postal service: that is, to maintain the current service which applies equally to all customers in the UK. The key features of the universal service are a national network and affordability. The national network is important to social cohesion, ensuring that everyone has access to reliable means of communication and the capacity to send/receive goods (incl. internet shopping). The single, affordable price protects the ability of vulnerable and low-income consumers to send and receive goods without the need for means testing. The universal service is therefore disproportionately important to those with disabilities, the elderly, and those on low incomes. Because the Bill aims to maintain the collection and delivery of letters on six days a week, rather than amend the specification of the universal service, we do not consider that there will be any adverse impact on equality, nor will there be any reduction in existing inequalities.

Rural Proofing

24. The universal service is disproportionately important to rural communities. Without a universal service obligation, rural communities would be more likely to suffer a degraded postal service as the costs of collection and delivery are higher compared to those for urban communities.

25. The Bill seeks to maintain the collection and delivery of letters on six days a week, rather than amend the specification of the universal service. As a result, we do not consider that the Bill will have any specific impact on rural communities.

Human Rights

26. We have considered the Human Rights Act and believe that the Bill is compatible with the provisions of that Act.