Royal Mail

Response to Ofcom's Call for input: Review of postal regulation – pricing and affordability

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Confidential information which has been redacted is indicated by: [✂]

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1. Executive summary

A sustainable Universal Postal Service that helps those who need it most

Royal Mail is proud to deliver the UK's one-price-goes-anywhere Universal Service Obligation (USO), connecting communities, supporting businesses and public services, and ensuring that everyone – wherever they live – can send and receive post at an affordable price. Mail remains one of the largest and most effective communication channels in the UK, even in an increasingly digital world. It continues to play a powerful role in communities and in the commercial success of companies whilst supporting central and local Government – and of course the NHS.

Mail does what no other media can; it delivers highly personal messages directly to the recipient's home and is also the most highly trusted channel. In a world of scams and deep fakes, people trust a letter that is delivered to their home. Fundamentally, mail plays an important role in promoting social cohesion and inclusion.

However, letter volumes have fallen dramatically over the last two decades, and are expected to halve again over the coming decade, whilst the number of addresses we deliver to has grown by four million and is set to increase further as the Government seeks to build 1.5m new homes during this Parliament.[1] Delivering fewer letters to more homes increases the delivery cost of each item of mail and puts at risk the sustainability and future of the USO – a model built for high letter volumes.

Addressing the sustainability of the USO is why the reforms considered in Ofcom's Call for Input, to introduce a targeted scheme in place of the safeguard cap as part of the need for continued evolution of the USO, are essential. As Ofcom observes, "*changing market dynamics have weakened Royal Mail's financial position and threaten the sustainability of the universal postal service*."[2] Stewardship of the USO is shared between Royal Mail, Ofcom and the Government. It is clearly in the shared interests of consumers, businesses and the UK economy to safeguard its future through proportionate and forward-looking regulation.

Alongside this, regulation must provide effective protection for those who need it most across the UK, in particular those who are already struggling with the cost of living. Regulation which applies the same blanket safeguard price cap to everyone, regardless of income, does not achieve this. It fails to help those who need it most. A more targeted approach, through a discount scheme, as Ofcom is considering, would ensure that postal services remain affordable for everyone, help those who need it most, and support a more sustainable future for the USO.

A discounted, targeted scheme helping those who need it most across the UK

Postal services in the UK are some of the most affordable in Europe. On average, we estimate that households spend just c.24p per week on stamps for letters, for the lowest income decile we estimate that it is just c.12p.[3] Ofcom's analysis finds that a 100g non-priority letter costs £0.87 in the UK, compared with £2.42 in France and £2.57 in Italy. In Denmark, where the USO for letters was abolished at the start of 2024,[4] it is almost four times higher at £3.39.[5] By contrast, the UK also still maintains a nationwide, one-price-goes-anywhere service. Whilst there is always more that Royal Mail can do to better serve its customers, the UK and businesses continue to benefit from extensive postal coverage and regulated service targets that are amongst the highest in Europe.

Replacing the outdated safeguard cap on Second Class stamps is essential to unlock flexibility and target support to those who most need it. A targeted scheme would make postal services meaningfully cheaper for those who need it most, whilst helping to safeguard the future of the service for everyone. As Ofcom notes, "*most people do not experience significant detriment as a result of postal prices, although there is some evidence that some vulnerable customers do experience affordability challenges*."[6]

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We are committed to developing a targeted scheme that would ensure those customers who need most help would have access to cheaper postage to stay connected with family, public services and businesses. This is fair, proportionate and fully consistent with Royal Mail's role as the UK's Universal Service Provider and Ofcom's statutory duty to secure the efficient and financially sustainable provision of the postal USO.

Affordability programmes already exist in other essential sectors such as energy, transport and telecoms. Whilst we broadly agree with Ofcom's principles for the scheme, we need greater clarity on Ofcom's overall approach to price caps before it is possible to provide a fully formed proposal for the scheme. However, in our view, a targeted scheme should:

- provide meaningful discounts to those who need it most;
- be easily accessible;
- be self-funding, rather than funded by taxpayers; and
- support Ofcom's statutory duty to secure an efficient and financially sustainable Universal Service, protecting the one-price-goes-anywhere service for all and allowing us to invest in benefits for customers overall.

By replacing an outdated price control with a targeted, evidence-based affordability framework, the reforms would support the Government's drive for smarter regulation, reducing unnecessary bureaucracy and enabling innovation in the postal market. Such an approach aligns with the Government's new framework for regulators, which seeks to reduce administrative burden on businesses by 25%.[7]

Taken together, the reforms would deliver an increasingly modern USO that is affordable for everyone, including those who need it most, and offers a more sustainable service to all customers in the long term.

Securing the USO for future generations – active stewardship

Affordability and sustainability are inseparable: protecting one without the other ultimately puts both at risk. A resilient USO depends on a delivery network that is financially sustainable, and Ofcom rightly recognises that affordability must be balanced with long-term sustainability.[8] As letter volumes continue to decline and we deliver to increasingly more addresses, we will need to closely monitor the sector to ensure the USO can continue to deliver benefits to all customers in a sustainable way.

[✂] Whilst we recognise that there is much that we can and need to do to continue to transform Royal Mail and to offer our customers more of what they want, removing the Second Class safeguard cap and replacing it with a targeted discount scheme will help protect affordability for customers whilst promoting a sustainable postal network. It would also delay when further, more substantive USO reforms become inevitable.

Ofcom has previously recognised that the net cost to Royal Mail of maintaining the USO is £325m to £675m per year.[9] Ofcom's July 2025 reforms – expected to deliver up to £300m in annual savings – were a vital first step towards modernising the USO. As a result, we are preparing to implement a new delivery model designed to deliver a more efficient, more reliable and more financially sustainable service for customers. However, the rapidly changing needs of our customers mean that USO modernisation is a journey, not a one-off event – and that journey continues beyond Ofcom's most recent decision. For that reason, further change is needed to ensure that the USO remains affordable for households and financially sustainable for the future. The replacement of the Second Class safeguard cap with a targeted scheme is a vital next step on that journey.

The Universal Postal Service requires active stewardship – ensuring it remains viable for future generations. This means undertaking regular health checks to identify risks early and enable

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proportionate, measured changes that avoid the need for more radical intervention later. Such an approach would help to safeguard the long-term sustainability of the USO and aligns directly with the Government's new framework for regulators, which commits to "*reduce uncertainty across our regulatory system*".[10] Sustaining the USO over time will require a strategic, long-term approach to regulation and oversight, underpinned by structural reform.

To deliver this vision of active stewardship, we call for a stewardship framework between Royal Maill, Ofcom and Government to strengthen transparency and shared accountability for the USO's financial sustainability. Under this framework, Royal Mail and Ofcom would hold an annual senior-level review of our business plan and long-term outlook, which would be followed by a report to Government. Where financial sustainability risks are identified, Royal Mail and Ofcom would both consider that they have responsibility for further analysis, and the development of reform options. The use of regular calculations of the net cost of the USO is common practice across a number of EU countries, including France, Italy and Poland.

We are committed to working with Ofcom and Government to deliver these reforms swiftly and responsibly, securing a USO that is modern, affordable and fit for the future. Together, these changes will deliver a discounted, targeted scheme for those who need it most and help preserve the UK's proud tradition of universal postal service for future generations.

Modernising the USO for customers

Modernisation is the other side of sustainability. For the USO to endure, it must evolve and respond to changing customer needs – for example, through the removal of the prohibition on tracking on USO services, the introduction of an additional Special Delivery end-of-day product to further improve consumer choice, reliability and efficiency and the removal of the unnecessary regulatory requirements, for example the requirement to offer an access fulfilment service.

These updates would ensure that the USO keeps pace with customer needs and expectations, whilst maintaining the highest standards of accessibility and trust. Further, Ofcom should also consider whether there is further regulation that is no longer necessary and could be removed, in line with the Government's Regulation Action Plan and its commitment to "*challenge unnecessary regulation*".[11]

Together, these reforms will deliver a USO that is modern, affordable and built to last; protecting customers today whilst preparing for the communications needs of tomorrow.

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2. Introduction: Sustainability of the postal USO is key: ongoing reform of postal regulation is inevitable

Key messages:

- Royal Mail, Ofcom and the Government share stewardship for securing the UK universal postal service into the future. This means recognising and responding to the inherent structural force of declining letter volumes, growing number of addresses and corresponding rising unit costs.
- This structural and irreversible decline has seen volumes fall from a peak of 20bn in 2004/05, to just over six billion by FY24/25 and, we forecast, [✂] billion in ten years' time. The effect of this is that the economics of a combined letter and parcel delivery network are being fundamentally unwound, creating serious sustainability challenges.
- International precedent demonstrates that successful reform involves ongoing change, not a one-off event. The experience of Denmark, which is ending its universal postal service at the end of this year, demonstrates that careful stewardship is necessary if the USO is to survive in the modern world.
- We therefore welcome Ofcom's Call for input (CFI), and recognition of both the sustainability issues and the need to balance other considerations, such as affordability.
- Over the longer term, we also ask Ofcom to work with us so that we can collectively take a strategic, forward-looking approach to ensuring the future of a sustainable USO. We provide some specific suggestions in Chapter 6.

Overview

2.1 In this chapter, we explain why continued reform of the USO is both essential and inevitable if it is to remain financially sustainable, efficient, responsive to change, and capable of meeting user needs over the long term. The evidence is clear that reform must be viewed as an ongoing process rather than a single event, if the service is to remain viable in a rapidly evolving market environment. We then go on to explain in the remainder of our submission:

- The financial case for reform, considering both affordability and the impact of the Second Class safeguard cap on our ability to become more financially sustainable (Chapter 3);
- Our initial thinking on a targeted support scheme to replace the existing Second Class safeguard cap (Chapter 4);
- Regulatory effectiveness and competition, including options for modernising price controls (Chapter 5); and
- Future reform and the shared stewardship framework between Royal Mail, Ofcom, and Government (Chapter 6).

Inherent structural factors are a major challenge to USO sustainability

Declining letter volumes, increasing number of addresses, and rising unit costs

2.2 Mail remains one of the most effective communication channels used by businesses and consumers across the UK. It delivers highly personal messages directly to people's homes in a way that other media cannot, and continues to play a powerful role in communities and in the commercial success of companies, as well as supporting central and local Government and the

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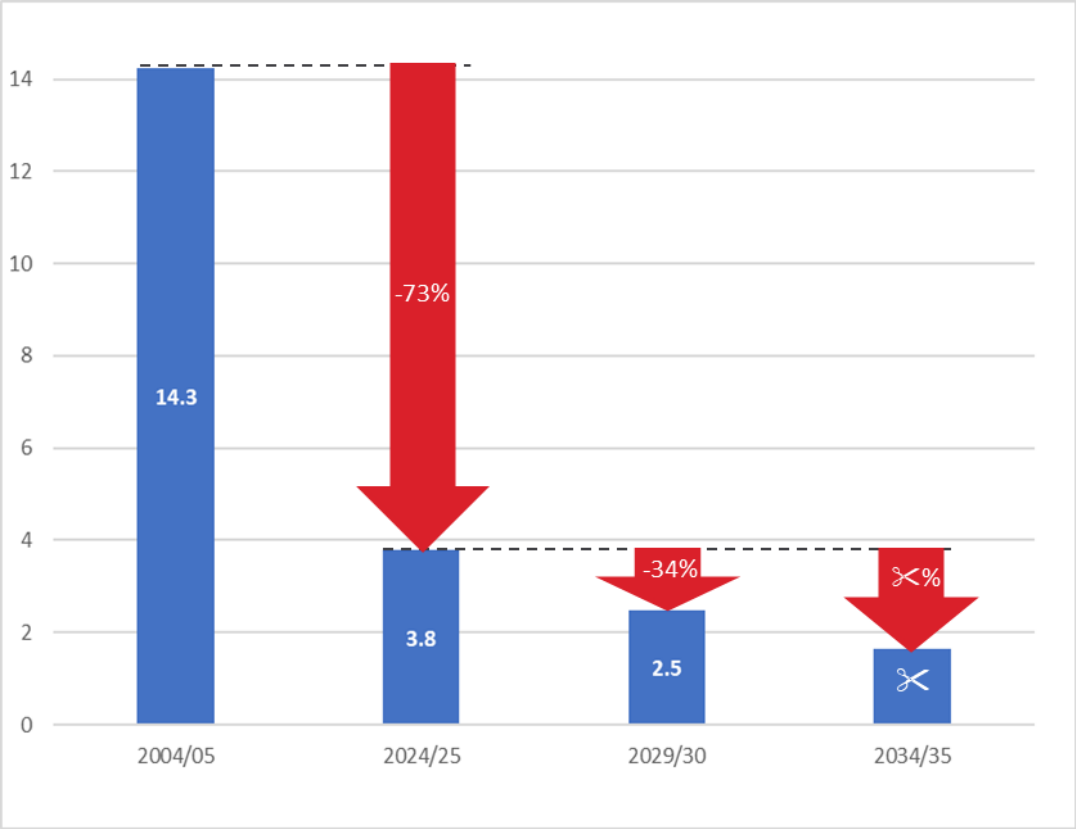
NHS. Mail is also the most highly trusted channel; in a world of scams and deep fakes, people trust a letter delivered to their home. Fundamentally, mail promotes social cohesion and inclusion. However, long-term trends continue to drive a fundamental decline in letter volumes; between 2004/05 and 2024/25, letter volumes have fallen by 69%, and we expect a further decline of around a third over the next four years.

2.3 As Ofcom observes in its CFI, the USO is under sustained, structural pressure, with letter volumes halving over the past decade and costs continuing to rise despite significant efficiencies across our network including the rationalisation of our mail centre estate.[12]

2.4 At the same time as letter volumes continue to decline, the number of addresses we deliver to has grown by four million over the last two decades and is set to increase further under the current Government policy to build 1.5m new homes during this Parliament. Our posties will deliver fewer letters despite walking past more homes and delivering to more addresses. Together, these trends mean the average number of letters delivered per address has fallen from around 14 per week at its peak to about four in 2024/25 – a 73% reduction. We expect letters delivered per address per week to fall further to 2.5 by 2029/30 (a further 34% reduction) and to [✂] letters by 2034/35 (a [✂]% reduction compared with 2024/25).[13] This structural decline is illustrated in Figure 2.1 below.

Figure 2.1– Letter deliveries per week per address[14]



2.5 Royal Mail's delivery network is largely fixed in scale and cost, meaning that declining volumes have a direct and compounding effect on unit costs. The same network must now serve more addresses whilst carrying far fewer letters, so the cost of operating the USO is increasingly spread over a smaller volume base.

2.6 The first phase of USO reform was an important step on the journey towards securing the Universal Postal Service. However, with letters per week per address forecast to decline by a further 34% over the next five years, the USO needs to continue to evolve and the introduction of a targeted scheme replacing the Second Class safeguard cap is an important next step in

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securing the USO. It is also consistent with the approach Ofcom took in its assessment of the net cost of providing the USO in its January 2024 consultation, where it assumed there would be no Second Class safeguard cap.[15]

2.7 Without further reform, these structural pressures will continue to erode efficiency and financial sustainability. Ofcom's ongoing work to modernise the regulatory framework is therefore essential to securing the long-term future of the USO.

The effects of this can be clearly seen on Royal Mail's finances

2.8 The financial consequences of these structural pressures are significant. Under the Postal Services Act 2011 (PSA 2011), Ofcom assesses financial sustainability by reference to a commercial rate of return. It has stated it *"considers an EBIT margin of 5% to 10% to be a first order indicator of whether the business is earning a commercial rate of return"*.[16]

Figure 2.2 – EBIT margin [✂][17]

[✂]

2.9 [✂]

2.10 [✂]

2.11 [✂]

2.12 Ofcom's July 2025 decision on USO reform was a key milestone and, once fully implemented, is expected to unlock up to £300m of annual savings across the network. These reforms represent an important step in modernising the regulatory framework. Royal Mail is preparing to implement a new delivery model designed to deliver a more efficient, more reliable and more financially sustainable service for customers. Early pilots have shown measurable gains in reliability, and we aim to commence further roll out from early 2026.

Our ability to transform to become financially sustainable is constrained by the absence of a level playing field in parcel competition

2.13 Ofcom has explained that to "*maximise the chance of the universal service being financially sustainable in the longer-term*" that Royal Mail needs to be able to "*achieve significant growth in parcels, effectively manage the decline in letter volumes, and significantly improve its efficiency*".[18] On the first of these three strands, our ability to grow in parcels is impacted by both overall customer demand for parcels and competition from other parcel carriers. Our ability to compete is restricted in part due to the different labour models deployed by different carriers. We do not compete on a level playing field with our peers because of current UK employment legislation and structural cost disadvantages.

2.14 Royal Mail does the right thing by its employees. It uses a fully employed model and Parcelforce Worldwide uses an almost fully (75%) employed model and we have a heavily unionised workforce. The majority of our competitors use self-employment or worker models (or use a mixture of self-employed and directly-employed workers), and have a largely un-unionised workforce. We face a higher level of NI contributions, we offer paid holiday, sick absence and pension contributions providing good quality jobs in the UK economy. However, this means we face significantly higher costs than our competitors who in many instances use self-employed or worker drivers. This limits our ability to compete unless Government plans to address the difference in labour models.

2.15 The difference in labour costs makes it harder for us to compete. Whilst letter volumes fall, the finances of the Universal Service network will increasingly rely on parcel services that use the

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same network – in the 2024/25 Regulatory Financial Statements, parcel revenues were more than 50% of the Reported Business revenue. If different, lower cost, employment models continue in parcel companies, it risks that, in the future, we will not be able to significantly grow in parcels given our existing employed and highly unionised labour model. As a consequence, there could be insufficient market revenue from parcel volumes to support the market-funded provision of the USO. Whilst Ofcom expects us to grow in parcels, it is hard to do this when there is not a level playing field in the parcels market to enable fair competition.

2.16 Structural decline in letters and a highly competitive parcel market make it essential that Royal Mail, Ofcom and Government continue to act proactively to protect the USO – including measures such as introducing a targeted scheme that supports those who genuinely face affordability challenges replacing the Second Class safeguard cap. This approach will help sustain postal services for everyone. Acting now on these smaller, timely reforms will delay when larger, potentially legislative, changes will be necessary.

International precedent shows that USO reform is a continuing journey, not a one-off event

2.17 Regulatory frameworks across Europe, particularly in Scandinavia, have evolved significantly in response to long-term structural change. In Denmark, the Government has removed the obligation on PostNord to provide a universal postal service (and it is expected that only commercial bulk letter services will remain after the end of this year). In other comparable markets, such as France, Germany and Italy, the USO has evolved incrementally to reflect shifts in consumer behaviour and local market conditions. For example, Italy applies different service levels across regions, whilst Germany has removed its next-day letter delivery requirement altogether.

2.18 In each of these cases, USO reform has been a continuing process of adaptation rather than a single point of change. The experience of other markets shows that whilst the direction of change is consistent, the pace and scope vary according to national circumstances. The UK's USO will also need to continue evolving to remain relevant, sustainable and deliverable in the modern communications landscape.

2.19 There is no single 'right' model for USO reform. Different countries have pursued solutions suited to their own circumstances. Our goal is to continue providing consumers with a high-quality, uniform, nationwide universal postal service; but further regulatory reform is required to ensure we can do so efficiently and sustainably.

Denmark highlights a possible endpoint: no postal service

2.20 The ongoing existence of the USO – and all of the benefits it brings to the UK – should not be taken for granted. Countries such as Denmark have already removed any obligation on PostNord to provide a universal letter service, providing a clear example of how far structural decline can progress if reform fails to keep pace with change. It is therefore vital that Ofcom uses this opportunity to reform the existing regulations to provide a more targeted solution in order to promote its long-term sustainability.

2.21 In 2000, PostNord Denmark handled over 1.4bn letters; since then, the rise of digitalisation – driven by a proactive Government policy making most official correspondence digital – has reduced volumes by more than 90%.

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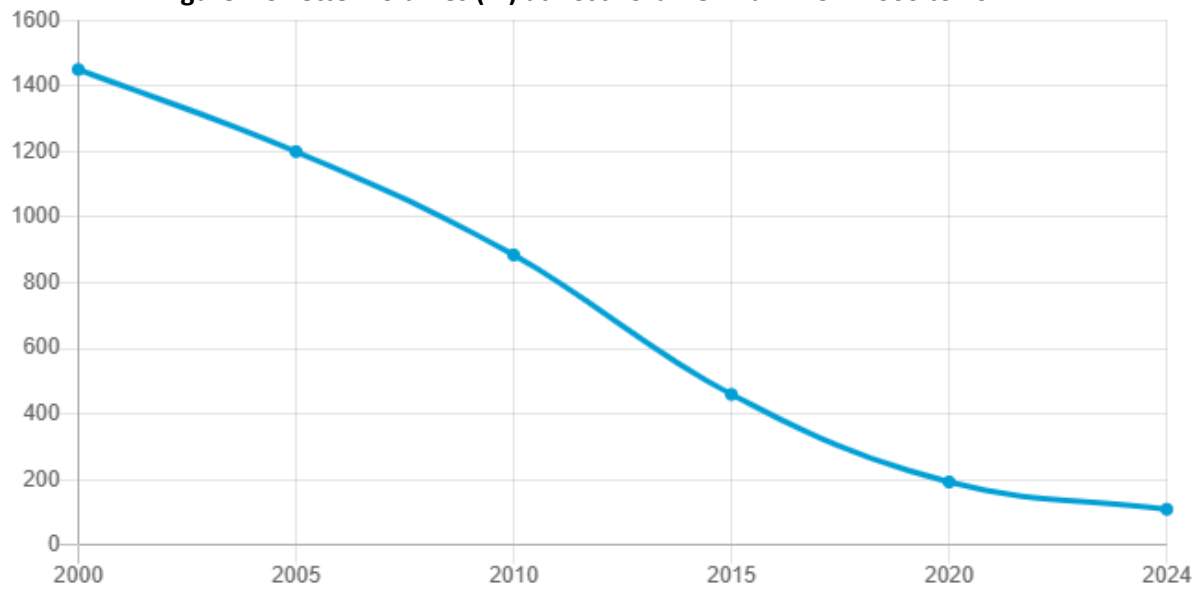
Figure 2.3 Letter volumes (m) at PostNord Denmark from 2000 to 2024[19]



2.22 As a consequence, letter volumes have fallen to such an extent that the obligation on PostNord to provide letter services has been effectively removed, except for a small number of residual obligations such as mail for visually impaired users, small islands, and international correspondence during a transition period. PostNord Denmark has announced that, from 2026, it will cease handling letters entirely[20] and expects all 1,500 mailboxes to be removed by 31 December 2025.

2.23 Under the PSA 2011, Ofcom has a legal obligation to secure a nationwide universal postal service, and the UK remains far more reliant on physical post for social, medical, and administrative communication. It is therefore essential that the UK takes proactive steps now to prevent such an outcome through measured, forward-looking stewardship of the USO.

The trajectory in other European countries: how some have ended up needing Government subsidy

2.24 Whilst Denmark illustrates the extreme end of structural decline – where the universal letter service has effectively disappeared – it is equally important to recognise another trajectory visible across Europe: the growing number of countries that have had to introduce subsidies to sustain their universal postal service when regulatory frameworks did not keep pace with falling letter volumes. We consider maintaining a market-funded USO remains by far the best model. But the international evidence shows that, without timely reform, subsidy can become the default outcome rather than a policy choice.

2.25 Several European countries now operate permanently with postal subsidies, whilst others have relied on them on occasions in recent years. Across the continent, a range of funding models has emerged: for example, France, Italy and Spain have all drawn on public funding or state-backed compensation arrangements to support the delivery of their universal postal service or related public service missions. Consistent with this wider trend, Cullen's analysis shows that 11 European countries currently provide compensation funding for the net cost of their universal postal service.[21] Against a backdrop of declining mail volumes and increasing financial losses by La Poste, in 2021 the French Government authorized state aid during the period 2021–2025 with annual payments in the range of €500 - €520 million. These payments were required to support the continued delivery of the USO and to support strategic transformation from a letter-centric model to a parcel-focused business.[22]

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2.26 Poland provides a particularly clear example of how subsidy pressures can escalate. Its operator-financed compensation fund meant that the designated universal service provider, Poczta Polska, was responsible for the vast majority of contributions – around 90% in one year – undermining the purpose of the scheme. Poland has since notified and secured approval for direct state compensation for the net cost of Poczta Polska's USO for 2021–2025. Poland did not move to this model as a matter of preference; it reflected the reality that the previous regulatory framework was not delivering sustainable funding for the USO.

2.27 These experiences underline a simple point: once subsidy becomes necessary, it rarely remains a small or temporary support. Subsidy frameworks tend to grow over time and, once introduced, are difficult to unwind. Countries that delay reform eventually face a binary choice between significant reductions in their USO or a shift to taxpayer funding, or a combination of the two. The UK can and should seek to avoid that path. But doing so requires proportionate, forward-looking reform now. Introducing a targeted scheme replacing the Second Class safeguard cap is central to securing an efficient and financially sustainable, market-funded USO.

We welcome Ofcom's recognition of sustainability challenges, the CFI and the wider reform agenda

2.28 We therefore welcome Ofcom's recognition of the material sustainability challenges facing the USO. As Ofcom states at the very start of its CFI, "*the number of letters being sent has halved over the past decade and continues to decline, driving up unit costs. The changing market dynamics have weakened Royal Mail's financial position and threaten the sustainability of the universal postal service*."[23] This clear acknowledgement provides an important foundation for the next phase of reform and underlines the need for a regulatory framework that secures both efficiency and long-term financial sustainability.

2.29 We also welcome Ofcom's recognition that affordability must be balanced with financial sustainability. In its CFI, Ofcom notes that whilst affordability is a key regulatory objective, it must also consider *"the risks to the sustainability of the universal postal service"*[24] and ensure that any safeguard measures, such as the Second Class safeguard cap, do not undermine Royal Mail's ability to operate on a commercially sustainable basis. This balanced approach is essential to achieving a regulatory framework that both protects users and secures the future of the universal postal service.

2.30 Timely, proportionate reform is now required to safeguard the USO. Ofcom's July 2025 decision on USO reform was a vital step, expected to unlock up to £300m of annual savings across the network. However, as structural trends continue to unfold, it is essential that Ofcom and Government continue to act proactively to secure the USO – for example, by introducing a targeted scheme that would replace the Second Class safeguard cap and that supports those who would genuinely face postal affordability challenges, sustaining postal services for everyone. Acting now will help avoid the need for crisis-driven change in short order, delaying more substantive changes to the USO further into the future.

2.31 As market trends continue to evolve – with letter volumes still falling and addresses increasing – Royal Mail, Ofcom and Government must maintain their shared stewardship of the USO to avoid the need for disruptive or crisis-driven changes later on. This means ensuring that the USO remains sustainable, efficient and relevant through steady, evidence-based adjustments. We expand on this further in Chapter 5.

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3. Second Class safeguard cap is ineffective to support those who need it most

Key messages:

- Affordability remains one of the most important features of the USO for our customers despite changing customer expectations; we support the principle of an affordable USO. Ofcom's CFI suggests that there is not an affordability issue for the vast majority of consumers and we agree.
- Overall, letters are neither unaffordable nor a significant part of household budgets, including for those on the lowest incomes. Spending on postal services has remained very low and broadly flat for many years. However, Ofcom has identified that a small minority of customers may face affordability pressures, particularly those on the lowest incomes. We have considered a range of options to address this concern. The existing Second Class safeguard cap is a blunt tool that provides very limited help for those that need it. By introducing a targeted scheme to replace the safeguard cap, we would be able to provide more support to those who need it most.
- There is no 'market power' justification for the safeguard price cap (or similar). Ofcom describes us as a monopoly in letters. However, Ofcom also recognises that the context is very different to the main regulated monopolies, with no concerns in the postal sector about excessive profits. For business mail, advertising mail, publishing mail and consumer mail, we are competing with a myriad of alternative communication channels, as demonstrated by the structural decline in letters we have faced and continue to face.
- We carefully consider our pricing decisions to ensure we set prices, for our customers, that are affordable, fair and reasonable, seeking to ensure we don't hit 'tipping' points as well as to help ensure the USO becomes financially sustainable.
- However, the safeguard cap materially limits our ability to maintain a sustainable USO. As well as the direct impact of not being able to increase Second Class stamp prices, it is causing us to set other Second Class prices at a level which is not in the interest of Royal Mail or customers (i.e. indirect impact due to 'pricing ladder' effect). It is forcing us to narrow pricing gaps between different services, providing customers with the wrong incentives when deciding which services best meet their needs. The indirect impact has the potential to negatively impact our financial sustainability at similar or higher levels than the direct impact.

Affordability is a key principle of the USO. We support this and price our services affordably for our customers

3.1 The move away from traditional communication methods towards digital alternatives has seen customers set new levels of expectation on the postal services they want and need. Despite these higher expectations, affordability remains a key tenet of a postal USO, with customers seeing it as a top priority.[25] Whilst reliance on post has declined over time, the vast majority of people say they will always need to send some things by post.[26] Customers want and need postal services now, and sustained into the future, at prices that are affordable. We understand the importance of this to our customers and we always consider our stamp prices very carefully to ensure they are affordable, fair, reasonable and seek to avoid hitting tipping points.

3.2 Ofcom set out its thinking in its CFI on how to approach the question of affordability. It is important that the approach correctly identifies different consumers groups' views on

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affordability, and identifies those groups who may face an affordability challenge, and the reasons behind it.

- we agree with the view that there is "*no single approach to affordability that can be definitive*"[27] due to the variance in people's incomes, how they use post and the importance of the items they are sending. Despite this, we agree that the best approach is to assess whether post is unaffordable by understanding whether people "*suffer significant detriment as a result of current prices.*";[28]

- we note Ofcom's comments that recognise the complexity of assessing affordability of postal services against a backdrop of the wider economic environment and cost of living concerns, and that a reduction of spend on stamps could be an indicator of consumers restricting discretionary spending in order to absorb the increase in the price of essential items. In other words, affordability concerns in post can be driven by general cost of living pressures rather than the cost of postage *per se*;

- we think that Ofcom's decision to focus on the affordability of letters is a sensible approach. The parcel market in the UK is highly dynamic and competitive, and with high levels of e-commerce penetration in the UK this is unlikely to change. In 2022, Oxera found that "*competition in the C2X segment is strong and we expect it to remain so*".[29] This ensures that parcels remain competitively priced. As Ofcom set out in its 2024 Post Monitoring Report "*competition in the C2X segment [applies] downward pressure on parcel prices.*";[30] and

- we agree with Ofcom that the best approach to assessing affordability of postal services is to focus on consumers, in particular those consumers who are more likely to be vulnerable to affordability concerns. It is crucial that the approach correctly identifies those groups who genuinely face affordability constraints with respect to post.

3.3 We note Ofcom's comments that its Residential Postal Tracker indicates that "*cost of postage could be influencing some people to review their own use of postal services*"[31]. The inverse relationship between price and quantity demand, and mail users exercising a choice to "*be selective about who they send [letters] to and 'trading down' from First to Second Class*"[32] are normal characteristics of a functioning market and not (*per se*) a cause for concern. We also note Ofcom's comments, based on its Jigsaw research, that some customers do not want to buy stamps in books of multiples when they only need one, and that the majority buy stamps at a Post Office branch where they are able to buy individual stamps. We see this as welcome – customers only pay for the service they need and not more, especially given that many will only use the post infrequently. Royal Mail offers a range of options to encourage all customers, both business and consumer, to consider what they genuinely need from a postal product, and then choose the most appropriate product to meet their needs.

3.4 Ofcom has identified that consumer spending on post has remained low over many years. According to the latest ONS data, the average household spends £623.30 per week, with just £0.60 per week spent on postal services (letters and parcels).

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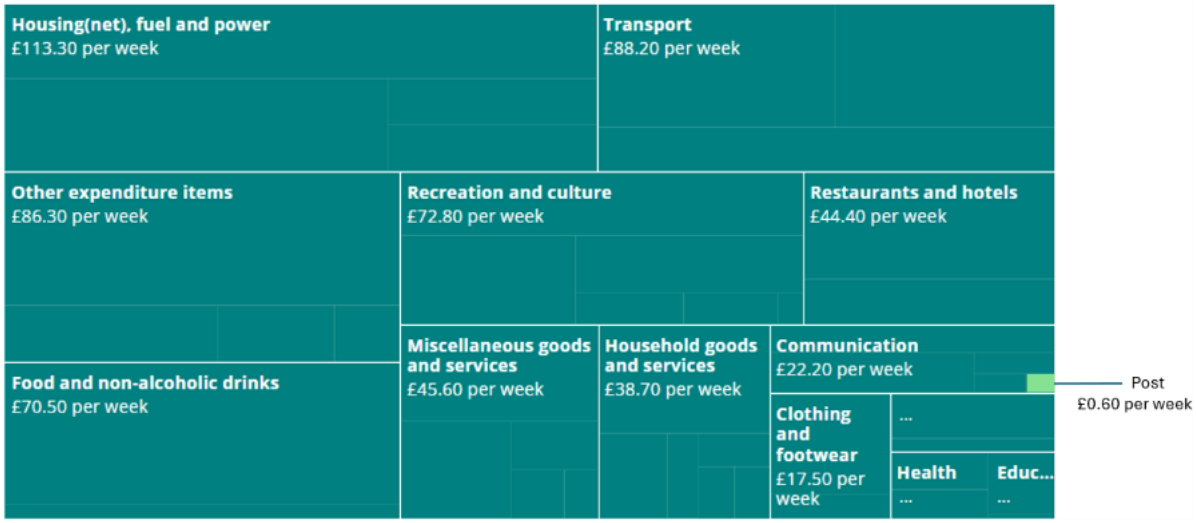
Figure 3.1: The average household spends £623.30 per week



3.5 According to the ONS, the average household spends £113.30 (18%) on housing and utilities and £88.20 (14%) on transport. By comparison, spending on all communications services is just £22.20 (3.6%).[33] **At £0.60, spending on post (letters and parcels) accounts for just 2.7% of household spend on communications, and less than 0.1% of the average household spend** and this spend on postal services has remained broadly flat for many years.[34] We estimate that less than half of this (c40%) is spent by consumers on stamped letters, c.24p per week.[35] When this is further disaggregated to customers in lowest income decile i.e. those more likely to face affordability concerns, we estimate the average is c.12p per week.[36]

3.6 We are pleased that Ofcom has undertaken qualitative research to better understand consumers' perspectives, and that Jigsaw "*over-recruited benefits recipients*"[37] to ensure their views were clearly heard. We note the finding that "*There was little evidence from the qualitative research to suggest that participants were frequently experiencing significant detriment".* We look at this more closely below in paragraph 3.14.

3.7 In considering whether our prices are affordable, we benchmark our prices against other national USO providers. Our First Class prices are in line with those we see from other operators around Europe. [38] Where most other operators in Europe charge two or three different prices for letters of different weights (0-20g, 21-50g and 51-100g), Royal Mail charges a single price. Both our First Class and Second class letters remain below the European average in all three weight bands.[39] This is the case despite service standard targets in the UK being some of the highest in Europe.

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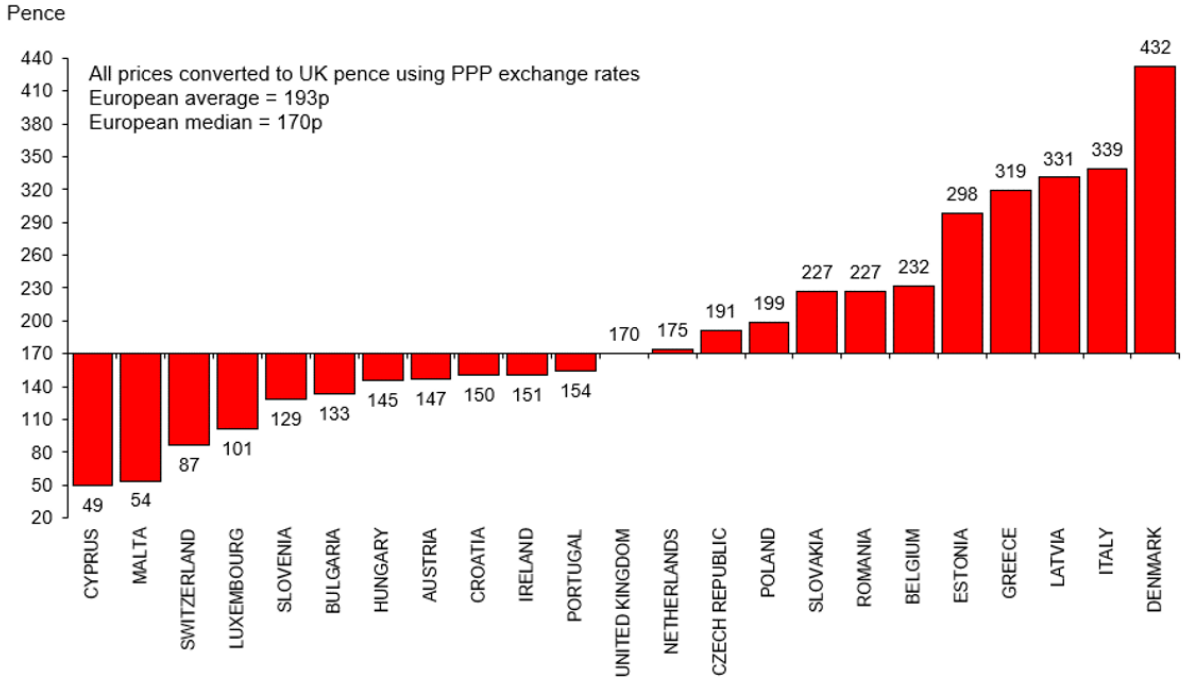
Figure 3.2: First Class average stamp prices 0-100g



3.8 Based on a weighted average, our First Class stamp letter price of £1.70 is below the European 0-100g average of £1.93 and remains comparable to the median price of £1.70. Not all countries offer a comparable next day service within the USO. Most of these countries would have a method to send a letter for next day for a premium. If we were to include these premium services within the price comparison, Royal Mail pricing would be even further below the EU average. We note that of the eight countries excluded from the graph due to a lack of comparable First Class service, six of them price their average Second Class 0-100g stamp higher than Royal Mail's First Class stamp. Royal Mail pricing of First Class stamps is in the middle of the European pack. With the exception of Italy and Romania (both more expensive), these comparator countries are materially smaller in both geography and population than the UK.

3.9 The Second Class price in the UK is materially lower than the European average and median prices. Comparing the price of a Royal Mail Second Class stamp at £0.87 to European average Second Class, stamp letter price, it is immediately apparent that the Royal Mail price is substantially below the European average of £1.56 and the European median of £1.62. This discrepancy is caused by the constraining impact of the Second Class safeguard cap which has increased only in line with CPI over time[40], but has not taken account of structural letter volume decline. We note that Ofcom has recognised "*letter prices in the UK may be below those in other countries*"[41] and that it will be considering this further in its review.

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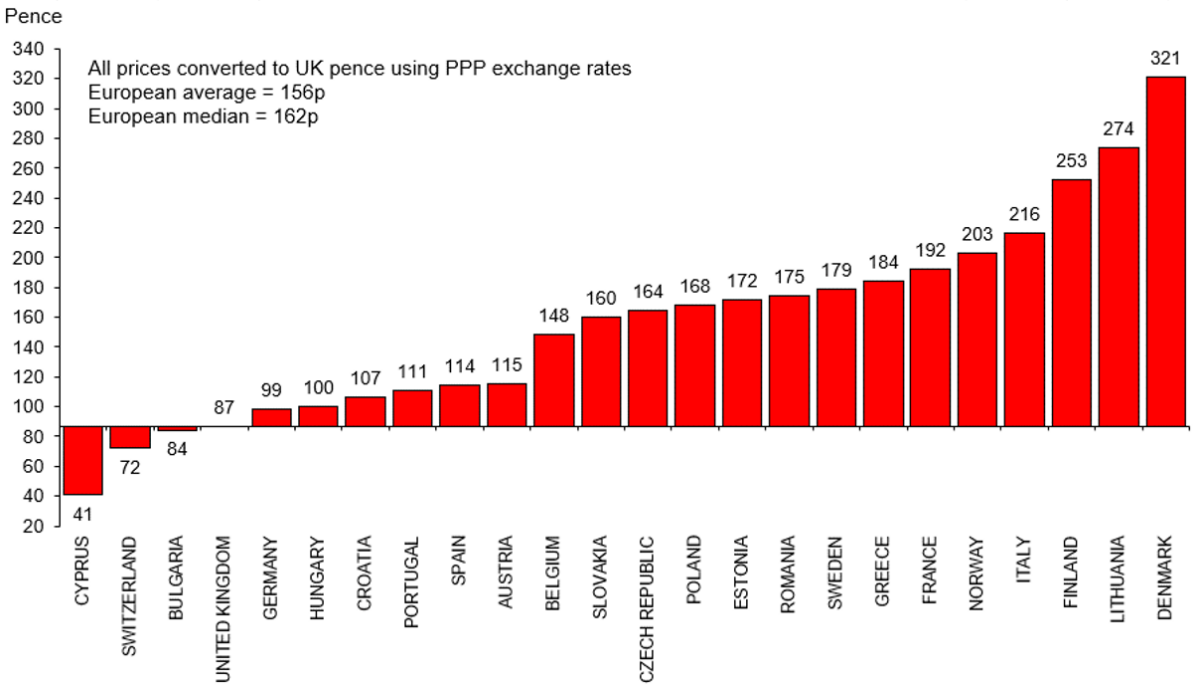
Figure 3.3: Second Class average stamps prices 0-100g



3.10 The level of financial burden that postal services place on household expenditure is very low, representing a tiny proportion of household spending. Our pricing of First Class is in line with the prices we see around Europe, and our pricing of Second Class is materially lower. Given the very low level of spending on post, it is difficult to see how this has a detrimental impact on household spending. On that basis, we agree with Ofcom's statement that "*most people do not experience significant detriment as a result of postal prices*".[42]

3.11 Stamps represent a very small portion of household spending. Moreover, purchasing a stamp is a one off transaction of a single item, without future commitments. This is unlike, for example, household utilities or mobile phone contracts which are generally provided under a longer-term contract and involve the consumer being automatically billed periodically. For example, a mobile phone contract which is automatically billed under a contract would cost on average £15.97 per month.[43]

3.12 Our one price goes anywhere USO service means that for just £0.87, a Second Class letter can travel over 1,100km from the Shetland Isles to the Scilly Isles. We have a complex and extensive network of trucks, planes and 80,000 posties to deliver mail across the breadth of the United Kingdom. This network – originally designed to deliver our six day a week USO letter service – drives significant fixed costs into our business. As a consequence, our costs do not fall in line with structural letter volume decline – we still need a network of trucks, planes, vans and people to be able to deliver the mail across the country, even if they carry and deliver fewer letters. As a result, the unit cost to deliver a letter continues to rise. Indeed, it is notable that the countries of a comparable geographic and population size (Italy, Spain, France and Germany) who offer a non priority letter service are all materially more expensive than the UK.

Some consumers, most particularly those in the bottom income decile, are more susceptible to external cost of living factors and may find affording postal services more challenging

3.13 We note that Ofcom has provided analysis of spend on postal services as a proportion of monthly disposable income net of essential spending on housing, energy, water and

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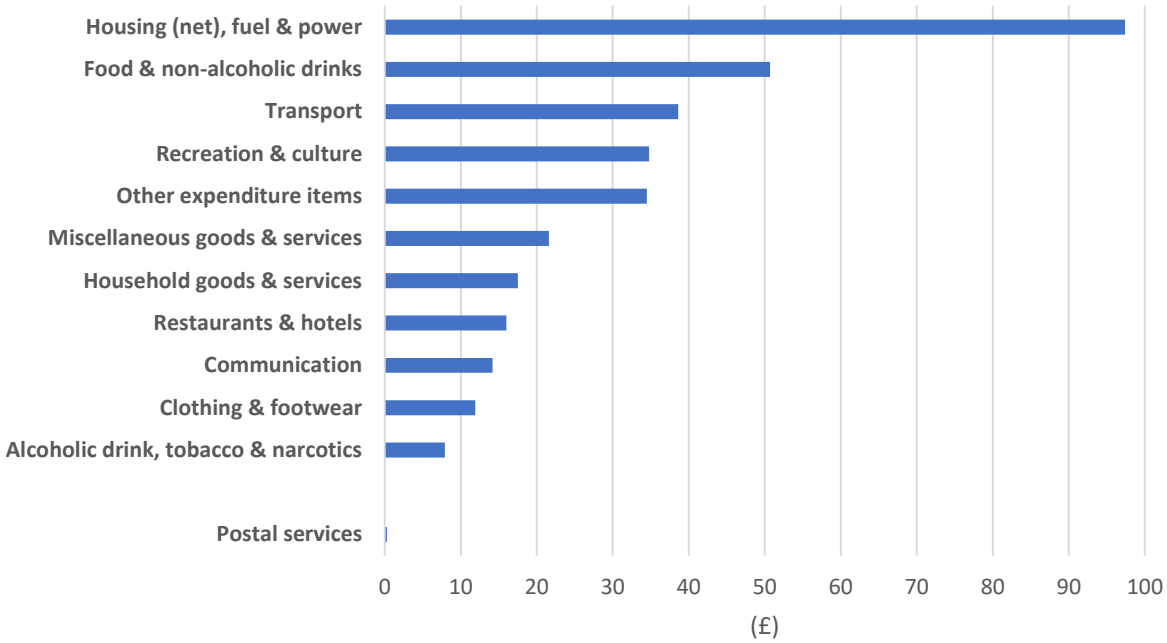
food/drink. The analysis combines data from two different ONS data sets. Whilst there are challenges in using two different sets of data in this way,[44] we recognise and agree with the underlying point that affordability concerns are more likely to be raised by those in the lowest decile of earners, and we have looked closely at this group.

Figure 3.4: Households in the equivalised bottom income decile ONS spending categories[45]



3.14 The average household in the bottom decile of income spends £385.60 per week, with just £0.30 spent on postage (letters and parcels). This amounts to just 0.08% of household spend. Based on Royal Mail analysis this would equate to around £0.12 per week spent on stamped letters (excludes large letters). This is a very small proportion of household spend, and compares to £97.40 (25.3%) spent on housing, £50.70 (13.1%) on food and £38.60 (10.0%) on transport, as well as significantly higher proportions on a range of discretionary categories.

3.15 Although, as we have set out above, spend on post in the bottom income decile is low, we do note Ofcom's comment that "*Some users in vulnerable groups are more likely … to claim that they have experienced affordability problems with post*".[46] We note that Ofcom has used its Residential Postal Tracker to demonstrate that higher proportions of people reporting concerns about postal affordability peaked between 2021 and 2023 which "*coincides with a period when cost of living was particularly challenging*"[47] and that there has since been a downward trend in consumers reporting affordability concerns with post. This suggests that concerns about postal affordability are, at least in part, driven by broader economic and cost of living challenges. – Indeed it may not be possible to separate out postal affordability from general economic pressures. We recognise that some users in vulnerable groups are more likely than average to claim they have experienced an affordability issue and further note that "*the proportion of respondents in the survey who have affordability challenges is likely to be overstated*".[48] It is, however, important to recognise that, even for those with incomes under £11,500 pa (the category of people for whom the highest proportion state experience of an affordability issue), fewer than half say there is an issue (38%).

3.16 We also recognise that those in the lowest decile of disposable income are more prone to external cost of living pressures and that at least some consumers in that group will also

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have a greater need to send more letters.[49] Consumers in that group would then be more susceptible to postal affordability challenges. We agree with Ofcom's assessment that consumers on lower incomes, those unable to leave home without help, benefits recipients and those with an impactful illness are more likely than average to claim they have experienced affordability problems with post.[50]

3.17 We have set out above why there is no general affordability issue in post. Even within the bottom decile of earners, postal prices appear not to be a major driver of cost of living challenges. However, we recognise that there are a minority of consumers who may be more likely to face an affordability issue as identified by Ofcom. Where affordability issues exist, the practical impact of the safeguard cap for those users is negligible. The Second Class safeguard cap is a blunt tool that targets support very poorly to those who may actually need it. We explore how a targeted scheme would be a more effective tool to help those consumers in Chapter 4.

There is no competition or market power justification for the Second Class safeguard price cap (or other price regulation)

Background

3.18 Price controls are generally used in industries that not only are natural monopolies, but also where businesses with significant market power can abuse that power to set excessive prices to make excessive profits. This does not describe the situation with the UK postal market, as Ofcom notes,[51] and is clearly demonstrated by our financial position. In 2024/25, the Reported Business[52] lost £15m, an EBIT margin of -0.2%.[53]

3.19 The update to the Hooper report in 2010 recognised this, pointing out that Royal Mail is "*not like other utilities*".[54] The primary reason being that "*The delivery of the universal service in the postal sector is under much greater threat than in other sectors which also have monopoly characteristic such as telecommunications, electricity, gas and water…… first, in contrast to these other sectors, delivery volumes….. are in sharp decline*". Ofcom, in its CFI, also recognises that the context is very different to other regulated monopolies, with no concerns about excessive profits.

Volume demand uncertainty means it is extremely difficult to set a Second Class safeguard cap that can secure the provision of the USO

3.20 The effectiveness of price regulation relies on the proposition that a price control will not, or not normally, be re-opened during the period of control, otherwise it undermines the efficiency incentives in a price control. The volume uncertainties in the postal market due to:

- customers having significant choice in how they communicate plus potential technological innovations that again could lead to a further change in customer posting habits leads to structural decline in letter volumes; and
- a highly competitive parcels market, makes it extremely difficult to set a price control, even on a single product. It has the potential to undermine our ability to provide an efficient and financially sustainable USO given the economics of the postal sector and is therefore incompatible with Ofcom's primary duty to secure the provision of the Universal Postal Service.

3.21 This is clearly demonstrated by the failed Postcomm regulatory regime, including:

- the failure to re-open price controls with sufficient speed when volumes began to fall at a rate that had not been anticipated; and

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- the difficulty in forecasting volumes in post with any precision will become more challenging over a longer period. Attempting to address this issue through setting shorter control periods (which might reduce volume risk) would give little incentive to efficiency gains.

3.22 This volume demand forecast challenge is uncharacteristic of other UK regulated industries – such as water and gas – where demand is fairly stable, easy to predict strongly correlated with overall economic performance and limited or no alternatives. Post can, in almost all circumstances, be substituted by other forms of communication. There are very few 'captive' customers of letter mail.

3.23 With volume uncertainty, if volumes were to be substantially below the forecast level under which the unit cost is calculated, then Royal Mail would not be able to recover the costs, as the USO imposes a high level of fixed costs that cannot be avoided. Hence, operating in a regime with binding price controls will risk a repeat of the errors of the Postcomm era and not lead to a financially sustainable USO, restricting our ability to invest and innovate to provide better services to customers.

3.24 We address other issues around price controls and the Postcomm regime more generally in Chapter 5, in response to chapter 5 of Ofcom's CFI.

Royal Mail faces significant constraints when making pricing decisions

3.25 When making pricing decisions we have to take a balanced and responsible approach. We need to balance a wide variety of factors, which are interrelated and in some cases may be pulling in opposite directions:

- ***tipping points*** – we face competition in letters from other forms of communication, as demonstrated by the shift to digital platforms, including Government's digitalisation strategy e.g. "one-stop" app launch in July 2025, which means we need to carefully consider price increases and consider whether customers will significantly reduce their use of mail or stop using mail altogether;

- ***how customers are likely to react to price changes*** – this is assessed through our elasticity and switching analysis. However, there is significant uncertainty on whether our elasticity estimates are robust to significant changes in prices;

- ***cost orientation*** – including how to seek to cover our cost, factoring in the increase in unit costs driven by the structural decline in letters, in a high fixed cost business;

- ***highly competitive parcel market*** – constraining our pricing flexibility in parcels hence limiting the contribution that parcels can make to the fixed costs of running the USO network;

- ***stakeholder interest and reaction*** – will price changes be seen as generally acceptable which in turn impacts on the demand for our services;

- ***meeting our regulatory obligations*** – our pricing decisions need to ensure our prices are fair, reasonable and affordable and within any price caps;

- ***financial sustainability*** – what level can we set prices to support the provision of the USO, enabling us to invest and innovate for customers, which will be impacted by all of the factors listed above; and

- ***benchmarking against other European countries*** – provides a useful benchmark to sense check that our prices are fair, reasonable and affordable.

3.26 In summary, being a high fixed cost business with declining letter volumes and few other means within our power to reduce cost (particularly given the extensive transformation activities we have already undertaken) has meant that we have had to increase some prices

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considerably in recent years. These are not decisions that have been taken lightly. We face a delicate balancing act between the need to cover our increasing unit costs against ensuring our prices continue to remain affordable for customers so they continue to use mail. Whilst the USO reforms will help to mitigate some of those cost pressures we will continue to operate in a challenging environment given structural decline in letter volumes and high levels of parcel competition. We increasingly face the prospect of hitting 'tipping points' with customers deciding to move to other communication channels in response to changes in our prices. Customers could choose to switch some of their mail to other channels, or stop using post as a channel completely leading to substantial volume losses. In this circumstance price increases are unprofitable for Royal Mail. It is not in our interests to hit tipping points as once customers stop using letters it is very difficult to encourage customers to return. It is extremely difficult to predict when 'tipping points' will be reached.

The Second Class safeguard price cap risks our ability to deliver a financially sustainable USO

3.27 For several years, we have been pricing to the level of the Second Class safeguard price cap. This results in market distortions, both:

- on our First Class and Second Class letter prices ('direct' impact); and
- on the price we can offer customers on other products (an 'indirect' impact i.e. pricing ladder). This impact can be significant and potentially as large, or larger, than the direct impact. We are increasingly forced to make pricing decisions that require us to narrow the pricing caps we consider to be appropriate between different products, resulting in potential distortions to customers choice of product or service. This distorts the prices we can offer customers for using more efficient channels, and also impacts our ability to drive efficiency in our operations.

Direct impact of the Second Class safeguard cap

3.28 The direct financial impact of the Second Class safeguard cap is the foregone revenue from not being able to set Second Class stamp letter prices at a level that is affordable, supports the financial sustainability of the USO and encourages efficient customer choices. It also impacts how we set First Class letter prices due to the interaction between the two services. We monitor the impact on customer posting behaviour of the price differential between these two services.

3.29 In an environment of declining letter volumes and a high fixed cost business, we need to be able to increase prices by above CPI each year just to seek to cover the increasing unit costs due to the structural decline in letters.

3.30 The Second Class safeguard cap only allows us to increase Second Class letter stamp prices by CPI each year. This has not been sufficient to mitigate for the structural volume decline. We need to have the flexibility to increase prices above CPI due to structural decline in letters and high fixed costs. While we are very mindful of the need to set prices at an affordable level due to both the risk of hitting tipping points and our regulatory requirements. In a high fixed cost network it is in our interest to keep as much volume (at a reasonable price) in our network as possible.

3.31 Under our USO reform proposals, which enables our optimised delivery model, we needed to ensure that the volume of all First Class letters (USO, Retail, Access) were optimised, otherwise this would undermine the viability of the combined routes in the delivery model. At the time we were making decisions on the April 2025 First Class stamp prices, there was significant uncertainty over how customers would react to this price change, plus additional uncertainty over the level of demand for the new mandated Access priority service. Hence, we considered the price increases implemented on our First Class services as necessary to support the USO

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reform delivery model. This dynamic is not present when we are considering the pricing of our Second Class stamp services.

3.32 The current Second Class safeguard cap and uncertainty over demand for the new mandated Access priority service forced us to take more risk on our recent decision the First Class price increase resulting in a significant widening of the gap between First and Second Class stamp prices.

Indirect Impact – pricing ladder effect

> The **"Pricing Ladder"** describes the hierarchy of prices that we charge for different channels and we carefully consider the price differences between these. Letters are sold via stamp, meter or account channels; within account, customers can also choose to sort and / or use a Mailmark barcode. Any price difference between products needs to be enough to encourage customers to use more efficient services and channels e.g. by covering the customers extra costs to meet the extra specifications needed.

3.33 The indirect impact on our pricing arises from the constraint that the Second Class safeguard cap places on other non-priority letter services due to the 'pricing ladder', which impacts on our ability to set prices to support the provision of an efficient and financially sustainable USO. The financial impact of decisions on both the level and the appropriate gaps between channels can have material impacts on our revenue. It is potentially as large, or larger than, the direct impact of the Second Class safeguard cap.

3.34 The Second Class safeguard cap is now resulting in economic inefficiencies – we are increasingly unable to price our products in a way that provides customers with greater choice, and drives efficient behaviour, such as encouraging the use of barcoding.

3.35 As with our considerations on stamp prices, there are many factors that feed into our decisions on the appropriate gaps in our pricing ladder, and we need to carefully balance all those factors when setting prices. The overall financial impact is highly dependent on the price differential assumptions in the pricing ladder, and it is necessary to consider a range of potential scenarios to understand the scale of the potential risk to the financial sustainability of the USO.

3.36 The overarching objective of our pricing strategy is to keep our services relevant and competitive with alternatives, which in turn ensures we can continue to provide the USO and maintain a one-price-goes-anywhere service to customers across the UK. As we explained earlier, there are many factors we consider when making those strategic pricing decisions. A key part of our strategy is to ensure that pricing differentials between our channels look to offer customers choice and to take account of operational efficiencies for us. Ideally the gaps between our channels would balance:

- the differences in Royal Mail's costs of providing these services;
- the value to the customer of the services and the choices they can make; and
- the cost to the customer of choosing these service. For example, a customer using franking as a payment channel needs to lease a franking machine.

3.37 A couple of the key areas where this is reflected in our pricing approach:

- the price gaps between Standard and Economy products which have given customers additional choice over speed of sending mail and price in the market. Our economy price is lower than our standard mail price, so customers can trade off a slower speed in exchange for a lower price. Meanwhile Royal Mail is able to handle this mail more efficiently via bundling

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of items which reduces the number of times we have to visit an address with non priority mail (i.e. Delivery to Specification, DTS), leading to improved operational efficiency; and

- the price differentials between machinable and non-machinable products in line with our barcoding strategy to

    1) incentivise customer to choose these products as they have lower prices;

    2) drive operational efficiency (as machinable products are more efficient to process); and

    3) optimise revenue protection and data from barcoded products.

3.38 When indicative prices are set, we then undertake price cost tests to ensure all prices meet the relevant regulatory tests (e.g. USPA6) and, if necessary, amend the prices to ensure this is the case.

3.39 The current Second Class pricing ladder table is set out in Figure 3.5 below.

Figure 3.5: Current Second Class Pricing Ladder – representative products

Product	Price (p)	Price Difference (p)	Rationale
Stamp 2	87	-	
Meter 2	84	3	[✂]
Business Mail Account	84	0	[✂]
Business Mail Unsorted Advanced 2	75	9	[✂]
Access Standard Manual	75	0	
Access Standard Mailmark (trays)	65	10	[✂]
Access Economy Mailmark (trays)	55	10	[✂]

Note: price differences rounded to nearest penny

3.40 More detail on the pricing ladder differentials are provided in Appendix 2.

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4. A significant number of people across the UK would be better off with a targeted scheme

Key messages:

- Replacing the Second Class safeguard cap with a targeted scheme will enable consumers who may face postal affordability issues to be better off whilst creating a regulatory framework that supports Royal Mail to become more financially sustainable, ensuring we can better meet the needs of all our customers in the future.
- We set out in this chapter our current thinking on the key principles that might apply to a scheme, building on those set out by Ofcom.
- The scheme should ensure that consumers who are considered to have postal affordability concerns will be meaningfully better off and that the scheme is effectively targeted at those who need support, is easy to access and use, be self-funding rather than funded by taxpayers, minimises economic distortions and minimises fraud.
- We need greater clarity on Ofcom's overall approach to price caps before it is possible to provide a fully formed proposal for the targeted scheme. The cost of a targeted scheme could vary greatly depending on a range of factors including the eligibility criteria, the level of take up, the level of discount offered, and the details of a usage allowance.
- The CFI is an important first step and we intend to refine our approach through engagement with different stakeholders as well as Ofcom.

Introduction

4.1 Given the evidence set out in Section 3 of Ofcom's CFI and in Chapter 3 above, it is clear that any affordability issues in post are narrowly focussed. As we have set out in Chapter 3, and in our response to Ofcom's 2023 consultation on the Second Class safeguard cap,[55] a price cap is a blunt and ineffective tool to achieve Ofcom's policy objectives. We therefore agree with Ofcom's initial view in Section 4 of its CFI that states "*[a] suitably designed scheme has the potential to help [it] achieve both of [its] key objectives, namely protecting the continued existence of the universal service and its affordability.*"[56] Removing the blunt instrument of a safeguard cap allows us to provide targeted support to those who need it most in society whilst delaying when further, more substantive USO reforms become inevitable, safeguarding an affordable one-price-goes-anywhere service for all and allowing us to invest in benefits for customers overall.

4.2 In this chapter we set out our current thinking on what the design principles and elements of a scheme could be. We are committed to developing our proposals further and need greater clarity from Ofcom to further refine them.

4.3 Our approach draws on:

- Ofcom and our own benchmarking of schemes in postal and other sectors (see Appendix 3);
- a review of the policy literature in relation to lessons learned from other schemes in the UK; and
- stakeholder engagement over several years including with Ofcom, the CABs and other consumer representatives, utilities providers and Government.

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Principles of a scheme

4.4 We welcome Ofcom setting out the design elements and principles of an effective scheme.[57] Our approach in developing a proposal is that the key principles of the scheme must be:

- that consumers who are considered to have postal affordability concerns will be meaningfully better off through effective targeting of the scheme at those who need it most;
- is easy to access and use;
- is self-funding, rather than taxpayer funded; and
- supports Ofcom's statutory duty to secure a financially sustainable USO protecting the one-price-goes-anywhere service for all and allowing us to invest in benefits for our customers overall.

4.5 Furthermore, in its implementation, the scheme should minimise economic distortions and minimise fraud.

4.6 Whilst we have adopted a slightly different approach when considering how to design a scheme, our approach is broadly similar to Ofcom's. In particular, we start with design principles and use these to assess a fuller range of options. Our approach is informed by, the Government Green Book guidance for options appraisal and evaluation, which starts with setting out critical success factors (analogous to design principles) and then using these to assess a long list of potential options.[58]

4.7 The figure below summarises our current thinking on the design principles to use in order to develop and assess different options for a targeted scheme.[59] This builds on our discussions with Ofcom, work carried out by various organisations looking at the take up of social tariffs in other sectors and our own thinking.[60] The text in italics indicates where we have added or added specificity to the principles set out by Ofcom. We note that there are a range of different measures of success and we agree with Ofcom that these need to be considered in the round, rather than focussing on only one measure.[61]

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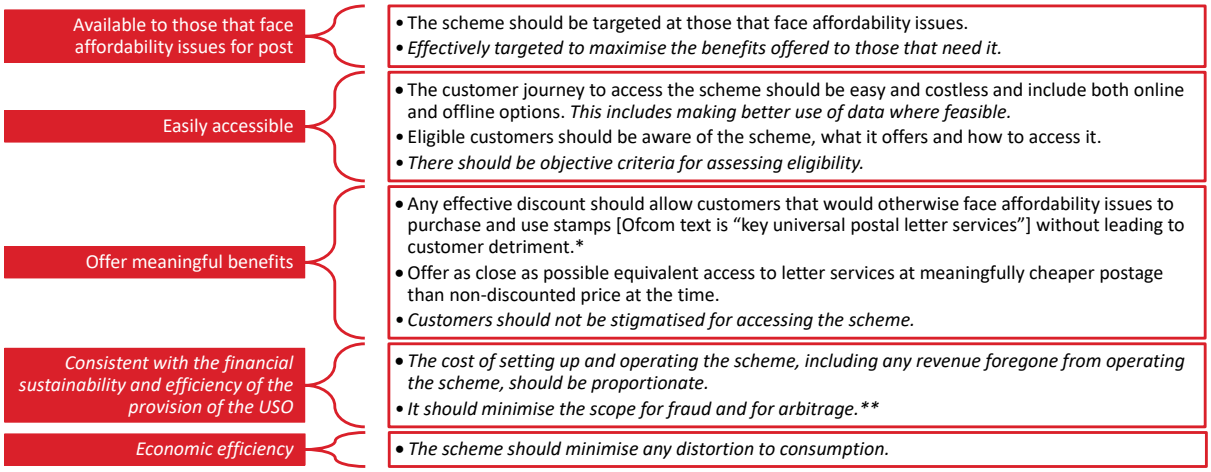
Figure 4.1: Design principles for a targeted scheme



** "Without customer detriment" refers to the Ofcom definition of affordability.* [62]

*** Arbitrage is identified separately here. Arbitrage occurs if an eligible customer gives or sells postage obtained through the targeted to scheme to someone else. Fraud would be if a customer obtains postage through the scheme even if they do not meet the eligibility criteria.*

4.8 We have considered the following design principles in addition to those set out by Ofcom:

- the scheme should be effectively targeted – other things being equal, the more the scheme is used by customers that do not face affordability issues, the less support could be offered on an individual basis to those that actually need it. Providing support to those who do not need it may also mean that the prices of other products and services (for the general population) would need to increase in order to cover the costs;
- there should be objective criteria for assessing eligibility – this makes it more easily understood by customers which should help to make the scheme more easily accessible. This also helps to ensure that the scheme is offered on a fair and consistent basis to those that need it;
- based on policy work in other sectors and Ofcom's qualitative research, we suggest that an important principle is that customers should not be stigmatised for accessing the scheme;
- the scheme should be consistent with the financial sustainability and efficiency of the provision of the USO. Whilst Ofcom's CFI does acknowledge the need for this[63] we consider this is a core design principle that should be considered; and
- economic efficiency – the scheme should minimise any distortion to consumption (e.g. by setting prices too low).

4.9 Based on previous policy work in relation to social tariffs in other sectors,[64] we suggest that, where feasible, the scheme should make better use of data in order to make the scheme more easily accessible to those that need it (e.g. linking of DWP and other databases). As we set out in the rest of this chapter, this may not be feasible in the short to medium term but should be a consideration in the longer term.

Scheme design

4.10 We broadly agree with the design elements that Ofcom proposes in its CFI.[65] The figure below provides an overview of the design elements that we have considered – the text in parentheses

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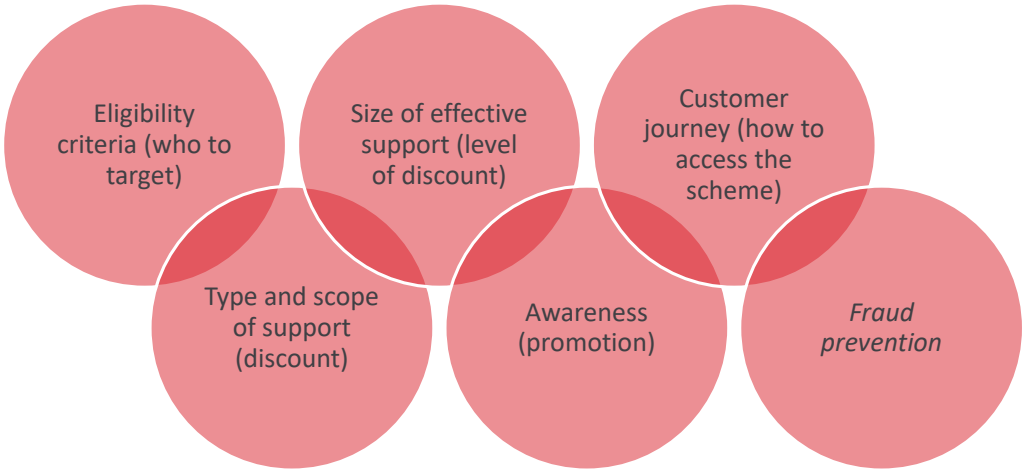
refers to the terminology used by Ofcom, and the text in italics refers to design elements that we have considered in addition to those proposed by Ofcom. We set out our consideration for each of these design elements in the rest of this section.

Figure 4.2: Design elements considered by Royal Mail



4.11 We have not linked each of the design elements to a corresponding design principle in the same way that Ofcom has done. There is a high degree of interdependency between the different elements and this affects the extent to which a design principle is achieved. For example, the way in which a scheme would need to be promoted would depend on how broadly it would be targeted or made available. Similarly, the way in which support is offered will determine the most appropriate customer journey. As noted by WIK in its report for Ofcom, "*each design option involves trade-offs*."[66]

4.12 As we set out below, we have considered a range of different options for how a targeted scheme could be designed. This includes the two broad choices that Ofcom identifies in its CFI (ensuring subsidised access to specific addresses and providing specific people with a discount on stamp prices),[67] as well as some additional options and variations (seasonal stamps and free stamps).

4.13 We have not considered different funding mechanisms as it would be self-funded through the removal of the Second Class safeguard cap rather than being funded by taxpayers. This is in line with cross-sector benchmarking we have undertaken. For example, whilst the Warm Homes Discount was established by the Government, it is the energy industry that provides the funding, and it is the BBC that is expected to fund free licence fees for over 75s. It is important that any scheme is well-targeted and efficiently implemented in order to minimise any distortionary effects.

Eligibility criteria

4.14 We note that Ofcom is at the initial stages of undertaking an affordability assessment and that its current view of which customers face affordability issues may change from its previous assessment. We agree with Ofcom's "*initial observation from the latest evidence that only a small proportion of residential customers are likely to face problems affording to send post*."[68] In the CFI, Ofcom notes that its previous assessment was that the groups "*more likely to be vulnerable in relation to the cost of post*" are older people, people on low incomes, people in rural areas, and people without internet access/ poor digital skills and people with disabilities.[69] Whilst Ofcom notes that the tracker is likely to overstate the proportion of people who face affordability issues,[70] Ofcom implicitly assumes that the tracker data can nonetheless be used to understand which groups are more likely to report having faced affordability issues. These groups are:

- those with income below £11,500 per year;

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- those unable to leave home without help;
- benefits recipients; and
- those with an impactful illness or condition. [71]

4.15 There are of course likely to be significant overlaps between these groups. Ofcom concludes that "*overall, we consider that people with low incomes are more likely to be vulnerable to increased postal prices*."[72] We agree with Ofcom that "*a scheme should be available to those on a low income so those who do rely on post can take advantage of it*."[73] We want the scheme to be available to those who need it whilst noting that, other things being equal, the wider the eligibility for a scheme, the lower the level of discount would have to be.

4.16 We also agree with Ofcom that it is practically difficult to identify who those people are and to offer help based on individual circumstances (as is seen in the water sector, for example) as we do not have an ongoing contractual relationship at the point of purchase. In addition, the cost of assessing individual circumstances is unlikely to be proportionate to the benefits of the scheme to those benefitting from it.

4.17 We understand that Ofcom's proposal is that eligibility should be based on receipt of Universal Credit or Pension Credit. Building on this approach, we also think it would be appropriate to include those in receipt of legacy benefits within the eligibility criteria.[74] This would bring the scheme in line with our existing Concessionary Redirection scheme. This would also reflect that the underlying eligibility criteria for these benefits are largely the same as for Universal Credit and it would therefore be coherent and responsible for us to reflect that in the eligibility criteria. Further, these benefits are gradually being rolled into Universal Credit[75] and will therefore have less of an impact over time. Using these eligibility criteria would mean around 11.3m adults in the UK (around 1 in 5 adults[76]) would be eligible for the scheme but may increase or decrease depending on prevailing Government policy and economic conditions.[77]

4.18 However we are concerned that this approach of using the receipt of means tested benefits as the eligibility criteria does not allow the scheme to explicitly target the groups that are more likely to say they have experienced affordability problems with post. It risks offering support to those that do not need it, at the expense of both those that do need it and are eligible customers and customers not eligible for the scheme. In particular, receipt of means tested benefits is an imperfect proxy for low income and not everyone who receives benefits will necessarily face postal affordability concerns, particularly if their usage of post is low or if they have few or no dependents.

4.19 Nevertheless, in the absence of a way to target the scheme better, it could provide a practical proxy, at least in the short to medium term. As Ofcom sets out, they are well recognised and capture a variety of reasons why people may have low income.[78]

4.20 Using objective verifiable criteria that customers can demonstrate relatively easily, and are consistent with those used in other sectors, also helps to make the scheme accessible. Some social tariffs in the water sector include a relatively comprehensive income and expenditure assessment in order to assess eligibility. However, such an approach would neither be proportionate nor practically feasible for post. Household spending on water is high and cumulative debt can be particularly problematic – neither of which are true for post. This increases the incentive for water companies to 'invest' in detailed individual financial assessments to avoid bad debt. In the longer term, in principle, there may be scope for these various schemes to be offered together, or at least for efficiencies to be found in their operation (e.g. better targeting of support and more streamlined customer journey).

4.21 We would welcome working with Government and Ofcom to understand who is genuinely vulnerable with respect to post as that would allow us to better target those who are genuinely in need (see below for some potential options).

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4.22 We also considered two alternative options that do not rely on eligibility criteria and would be available to all.

4.23 First, we considered offering free or subsidised access to specific recipient addresses (e.g. DWP or NHS).[79] Ofcom also considered this option in its CFI. We agree with Ofcom's conclusion that this approach is likely to be too narrow.[80] In addition to the reasons set out by Ofcom (that it is too prescriptive and does not necessarily reflect the broad range of needs of people who face affordability issues), we consider that such a scheme is not appropriate for the following reasons:

- it offers poor targeting of support – there would be no way to prevent people who can afford to pay for postage from using it. As noted in the WIK report,[81] it would be difficult to prevent businesses from using the scheme;
- it distorts consumption – by offering postage below the cost of provision, it may encourage more use of post when alternative, more efficient communications means are available. Not only does this affect Royal Mail but also the organisations receiving letters as there may be a knock on cost impact on organisations receiving mail physically rather than electronically;
- it is complicated to work out which addresses should be Freepost;
- Royal Mail already provides Business Reply and Freepost services on a commercial basis, with the Department of Health and Social Care and NHS trusts being the biggest users; and
- it would lead to revenue reduction if organisations currently paying to use Freepost addresses expect the cost to be borne by Royal Mail instead.

4.24 Given these issues, we do not currently consider that offering this in addition would offer any materially greater benefits to customers facing affordability issues and would not support a more efficient and financially sustainable USO.

4.25 Second, we have done some initial thinking on offering a seasonal stamp informed by those offered in Australia, Finland and the Netherlands**.** These seasonal stamp offers do not have an eligibility criteria, are open to everyone and are for specifically designed stamps (i.e. distinct from the stamps offered throughout the year).

Figure 4.3: International benchmarks of seasonal stamp offers

Country	Seasonal stamp offer
Australia	Christmas stamps are available to purchase during November and December. The international stamps can be used for their denominal value year round, but the domestic stamps can only be used between 1 November and 31 December. [82] These are currently sold for $0.65 each (62% discount relative to standard stamp for $1.70), and are sold by Australia Post as single stamps, or in multiples of 5 for international stamps) or 10 for domestic stamps. [83]
Finland	Christmas stamps can be purchased from late November to mid-December for €1.70 (38% discount relative to standard stamps for a 50g letter for €2.75), or €2.70 if posted after 16 December (2% discount relative to standard stamp).[84] The stamps have no denominal value and cannot be used outside of that period.[85] Stamps are purchasable from Posti in multiples of 20.
Netherlands	PostNL offers 'December Stamps' between mid-November and early January. These stamps can be used for the denominal value outside of that period. In 2024, these were priced at €1.06 versus a full price stamp of €1.21 (12% discount). PostNL sells them in books of 20 stamps. [86]

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4.26 A seasonal stamp may help customers at a time of year when household budgets can be more challenging and when usage of postal services is traditionally higher. It would also be easily accessible as it would likely be available across retail channels and customers would not need to demonstrate eligibility. However, as it is not targeted at the customers that face affordability issues and take up could be wide, it limits the support that can be offered to individual customers. Hence it does not appear to be a good match to the design principles set out at the start of this chapter.

4.27 A further alternative we are going to consider is based on a suggestion that was made at our recent USO reform customer engagement forum. It was for a new economy stamp that would be available to all at a lower price than Second Class stamps and would offer a slower delivery speed. This is an area we will explore further over the coming months.

Type and scope of support (discount)

4.28 In considering the type and scope of support that we would offer to eligible customers, we considered which USO products should be included and whether the support would be better in the form of discounted postage or a fixed number of free stamps.

4.29 We note Ofcom's initial view that "*a targeted scheme should offer eligible people access to key universal postal letter services*"[87] and that this should include First Class and Second Class letter services. We are currently exploring whether a targeted scheme should include First and Second Class letter services as a possible solution. Whilst we note Ofcom's research which finds that the proportion of people using First Class all of the time is decreasing whilst the proportion using Second Class all of the time is increasing,[88] Ofcom's qualitative research showed that a scheme that only offered Second Class is unlikely to be sufficient.[89] Further, as Ofcom notes, First and Second Class are more frequently used compared to other USO services such as Special Delivery (Guaranteed by 1pm), international delivery services and Keepsafe. [90] Given the low use of the other USO services (and therefore expenditure on these), any scheme is unlikely to have a material impact on individual customers ability to access postal services but could have a material impact on Royal Mail.

4.30 As Ofcom notes, any savings eligible customers make on First and Second Class stamps can be used to pay for other services.[91]

4.31 Providing eligible customers with a discount on specific products appears to us to closely align to the design principles we have set out better than offering a fixed number of free stamps. This also appears to align with Ofcom's thinking as set out in Section 4 of the CFI.

4.32 Offering discounted stamps offers the following advantages relative to offering free stamps:

- it is easily accessible as it allows customers to purchase stamps when they need them rather than receive them when their application is accepted. This allows us to monitor usage more effectively;
- we agree with Ofcom that it reduces the scope for fraud and the incentive for arbitrage as consumers are more likely to only apply for discounted stamps if there is a personal need;[92]
- if customers are able to set up an online account (or if Royal Mail can do so on their behalf), it allows us to have a fair usage policy and therefore limits both the incentive and scope for fraud and arbitrage (see below for further details). It is also less likely to lead to increased unused stamps than offering free stamps which represents a revenue risk to the business;
- it is consistent with economic efficiency if the price reflects the underlying cost. Charging a price that reflects costs ensures that consumption is not distorted and it limits the incentive for customers to "*over consume*" stamps i.e. to post more items or to post to a higher specification (e.g. post First Class rather than Second Class);

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- in a similar vein, it is consistent with the financial sustainability of the USO. By requiring customers to pay for their stamps, it ensures that people still only use post (and the resources associated) when they value it; and

- it is akin to social tariffs offered in other sectors where the tariff is discounted and provided by a commercial enterprise (e.g. water and energy). There are very few circumstances where a service is provided free of charge.

4.33 Offering discounted stamps does also have disadvantages. First, it is more complicated and expensive for us on both an up front and an ongoing basis, particularly if we need to rely on third parties. However, this is likely to be outweighed by the benefits from limiting fraud and arbitrage (see section below on limiting fraud). Second, the customer journey may be more complicated as it requires a customer to opt into the scheme as well as pay for stamps (albeit less than the commercial price). See section below for further detail.

4.34 We agree with Ofcom that any scheme would need to offer customers a meaningful discount relative to the headline price.[93] However, as we set out in further detail below, at this stage it is not possible to determine what level of discount we would offer and whether this would be applied as a percentage discount to the headline price or whether it would be a specific discounted price.

4.35 We also considered whether we would offer a specific discounted stamp (as in the case for Australia Post's concessionary scheme) or whether we would offer a discount on our existing stamps. We are conscious that the creation of a specific stamp would risk stigmatising customers that use it. We also note Ofcom's research into the hidden barriers to take up of social broadband tariffs which included a perception that cheaper deals meant less reliable broadband, with consumers associating low price with low quality.[94] Using existing stamp products also helps to minimise the costs of running a scheme by avoiding the cost of designing and distributing new stamps, as well as avoiding complicating our product offering. Based on initial thinking, we consider a discount is likely to be better for consumers than a concessionary stamp.

Awareness (promotion)

4.36 We agree with Ofcom that raising awareness of any scheme in an accessible way online and offline is very important as lack of awareness can be a barrier to overall take up.[95] High levels of awareness of a scheme will be key to ensuring that the scheme is easily accessible to those that need it. We also agree with Ofcom that any promotion needs to be in plain English and that support should be available across multiple channels should people have any further questions.[96] We would add that promotion would also need to be carried out in Welsh.

4.37 In addition to the channels identified by Ofcom,[97] we are exploring the following options:

- using postmarks to raise awareness of the scheme and to signpost to further information;

- the role of the consumer advisory bodies (CABs) in their respective statutory roles as consumer advocates in the postal sector as well as helping people – particularly those on low incomes – to access a wide range of broader essential services; and

- liaising with local and central Government. For example, in the broadband sector, Citizens Advice recommends increasing awareness of social tariffs, including targeted advertising campaigns run by Government (e.g. using Job Centres and Universal Credit journals[98] as a contact point).

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Customer journey (how to access the scheme)

4.38 We agree with Ofcom's initial view that an application-based scheme, where eligible customers opt-in rather than being automatically enrolled, allows the scheme to be better targeted and therefore potentially provide a higher discount.[99] This is particularly the case if Universal Credit and Pension Credit are used as eligibility criteria as this would mean 11.3m people would be eligible,[100] not all of whom – as Ofcom notes – will face affordability concerns.[101] We also note that there would be significant practical difficulties with implementing such an approach as Royal Mail does not have the right to access the DWP data to identify eligible customers under the current legal framework.

4.39 We agree with Ofcom that the scheme should be available through a wide range of channels.[102] This is also consistent with the Jigsaw research. [103] We believe an online application would be the preferred route for the majority of applicants. Ofcom's research indicates that people without online access or who have difficulties using the internet tend to have someone available to help them.[104] For customers that do not have internet access, we would envisage also offering an offline customer journey. Both these options are described below.

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Figure 4.4 Considerations for the online and offline customer journeys

Online customer journey	Whilst an online application may take time to develop and come with higher upfront costs, it may have lower running costs as more of the process can be automated. Similar to our existing concessionary redirections scheme, for customers applying online, we would accept digital proof of eligibility (e.g. letter from DWP confirming receipt of eligible benefits or proof of benefits available from the DWP portal.[105] When applying for the service, applicants would be asked to supply proof of eligibility (e.g. DWP letter or bank statement showing receipt of eligible benefits). This would be the same as our established process for our concessionary redirection scheme. Once eligibility has been confirmed, Royal Mail would issue a concession account that would allow the customer to purchase books of discounted stamps via our online shop, up to the agreed allowance (see section below on fraud).
Offline customer journey	For customers without internet access or digital skills, we would propose to accept applications via telephone through our Customer Experience team or by posting applications directly to us. Once an account is set up, customers would also be able to purchase books of stamps via telephone. In order to do either of these, we would need to invest in increasing current capacity. Applications forms would be available via our existing Customer Service Points in local delivery offices. We are currently exploring whether application forms could be made available via third parties in the similar way to how we did for the stamp barcode swap out scheme. At this stage, we consider that these online and offline options would likely meet the vast majority of customer needs at reasonable set up cost. For example, if we were to offer access to the scheme via a third party, significant IT investment would be required to link Royal Mail systems (where the eligibility would be verified) with the third party systems (where the stamps are purchased) in order to ensure customers receive what they are eligible for and to limit fraud. Any investment would be likely to be both costly and require significant amount of time to implement. It would also potentially reduce the support that we are able to offer to customers.

Verifying eligibility

4.40 Irrespective of whether customers apply online or offline, we agree with Ofcom that there should be a simple process and it should be clear to customers how the eligibility verification process works and how long the application is likely to take.[106] We also agree with Ofcom that there should be no sign-up costs or annual fees for applicants.[107]

4.41 We agree with Ofcom that people should not be required to prove ongoing eligibility too often. Our current thinking is that they should only have to do so once per year.[108] This balances the need to ensure the scheme is easy to access against the need to ensure that support is targeted given that an individual's receipt of benefits can change at any point in time.

4.42 In the future, it may be possible to improve the application process in two main ways. First, if the eligibility criteria for the stamp scheme are the same as those in other sectors, one option could be to piggyback onto or integrate with existing schemes.

4.43 Second, we understand that organisations such as Policy in Practice are working to improve data sharing between relevant bodies to reduce the administrative burden of applying for

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multiple low value benefits.[109] Policy in Practice also has a Better Off Calculator that users can access through its clients or through GOV.UK to check eligibility for benefits. Many get direct access to support schemes with a single click through its Apply Once capabilities.[110] There may be scope to include the targeted scheme here, subject to cost.

Fair use and Fraud prevention

4.44 As described above, if the proposed eligibility criteria are based on receipt of Universal Credit and Pension Credit, this would bring around 11.3m people into the scope of the scheme. Whilst this may be a practical back stop solution, it creates a very significant liability for Royal Mail in order to provide a benefit to those who need it most. Even if we are able to find a way to better target the scheme (see section above on eligibility criteria), it will be key to prevent and limit fraud in order to ensure the principle of financial sustainability is met. There are three main ways that we would seek to do this:

- first, we would put in place a robust system for checking eligibility (see above);
- second, we consider a usage allowance would limit the scope for both fraud and arbitrage. This would also help to limit the overall cost of the scheme, potentially allowing us to offer a more meaningful discount and also to minimise any implicit cross-subsidisation between customers. Given that low income customers tend to have lower usage, a usage allowance is likely to benefit those customers more than offering a lower discount on a greater number of stamps. As described above, it is difficult to determine how many letters eligible customers would need to send and therefore what an appropriate usage allowance would be; and
- third, we would propose to limit fraud include specifying in the terms and conditions of the scheme that stamps purchased through the scheme are for personal use only and should not be given or sold to anyone else.

Size of effective support (level of discount)

4.45 We agree with Ofcom that it is important that *"the targeted scheme provides specific people with a discount on stamp prices"* and that *"the discount is meaningful and of use to those people facing problems affording to send post."* Further, as Ofcom notes, determining the level of discount and how that discount is provided is complex.[111] In addition to the reasons for this set out by Ofcom, we note that there is no single objective way of establishing an affordable price and therefore what the appropriate discount should be. As described above, unless the price is set to zero, there will always be some people for whom the price is unaffordable. It is also unclear whether customers would prefer a percentage discount or a discounted price.

4.46 We also note that there are issues with determining the level of discount that relate to uncertainty and may be resolved as more information becomes available.

4.47 There are several reasons why it is difficult to determine what the discounted price or percentage discount should be. Whilst some of these are inherent in nature, others relate to uncertainty and may be resolved as more information becomes available.

4.48 In particular, the discount we are able to offer will depend on the degree of pricing flexibility that we are permitted and financial sustainability considerations.

4.49 The discount we are able to offer will also depend on the costs of setting up and running the scheme. This will depend on the level of take up of the scheme which is currently uncertain, particularly as no comparable scheme has been implemented in the UK postal sector to date. It is also difficult to estimate how many stamps customers would need as there is currently relatively limited robust data on how many letters people in the target group would need to send and how many stamps they would purchase, not least because some customers will buy books of stamps and will not use them as soon as they purchase them. We would like to engage

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with relevant stakeholders further to understand what level of usage allowance would best meet the needs of customers that face affordability issues.

4.50 Ofcom's suggestion to have a fixed budget model has both advantages and limitations. In particular, we agree with Ofcom that the overall cost of the scheme needs to be limited to some degree.[112] We recognise there is a risk of very low take up and that the scheme might not create the benefits that we are seeking to create with it. Whilst we do not consider this likely, we understand why this would be problematic. We propose regular periods of review of the scheme that would give us the opportunity to work with Ofcom to consider how to adapt the scheme in the event of very low take up. Nevertheless, we consider that there are three main limitations;

- first, changing the discount level or the number of stamps available frequently reduces the clarity and predictability for those who are eligible and this could compromise confidence and take up of the scheme. It is also important to provide clarity on pricing to allow customers to manage their budgets effectively. We typically limit our stamp price changes to twice per year;
- second, we also consider that the scheme should – at least to some extent – be demand led, with more being spent on it if there is a genuine need; and
- third, fixing the budget for just one year and then making quarterly adjustments does not provide Royal Mail with sufficient certainty to make commercial and operational planning decisions plus it creates customer confusion. In practical terms, if the scheme is offered via third parties, it takes time to notify them of any changes.

Next steps

4.51 In order to refine our proposals for a targeted scheme, we would welcome further engagement including:

- continued engagement with stakeholders. In particular, with the CABs, given their statutory duty as representatives of postal users and their insight into social tariffs in other sectors; and
- further evidence gathering and design work to create a proposal that would better support customers who have postal affordability issues.

4.52 In the longer term, there are a number of areas where further work and better sharing of best practice across different sectors may lead to further refinements of the scheme. We understand that in other sectors low take up of social tariffs is driven, in part, by "*administrative complexity and fragmented provision*" across different providers.[113] Therefore, if there is a high degree of overlap between eligibility criteria across different sectors, there is likely to be scope for either automation of the application process to enable customers to apply for all social tariffs/schemes through a single point, potentially through an arm's length body;[114] or better sharing of information with customers claimants giving their consent for data to flow.[115]

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5. We agree with Ofcom that other price controls are not appropriate

Key messages:

- We agree with Ofcom that replacing the Second Class safeguard cap with other price controls would be unnecessary and undesirable. Many of the same concerns we set out in Chapter 3 in relation to the Second Class safeguard cap would apply to setting additional price caps in other areas of the business. In particular, as well as being unnecessary, price controls would be difficult to set and therefore carry a high risk of undermining sustainability.
- We do not consider that it would be necessary or appropriate to tighten the approach to Access pricing – Access operators (together) have the lion's share of the bulk mail market. Rather, the regulatory margin squeeze test is undermining our ability to compete.
- The regulatory margin squeeze test is undermining our ability to compete, and we ask Ofcom to review and reform USPA6 so that we can compete fairly in the upstream bulk mail market.
- We do not consider that it would be necessary or appropriate to tighten the approach to Access pricing – Access operators (together) have the lion's share of the bulk mail market. Rather, the regulatory margin squeeze test is undermining our ability to compete.

We agree with Ofcom's view that price controls are unlikely to be effective

5.1 We set out in Chapter 3 of this submission, the problems with price regulation in postal services. These were made in the context of retaining the Second Class safeguard price cap but are equally relevant to the other forms of price control discussed in Chapter 5 of the CFI. In short, as well as the market situation not requiring price controls (there is not a risk of excessive pricing that represents a market power abuse), and the limited affordability problems being poorly addressed by a market wide price cap, there is significant uncertainty over future volume which makes setting price controls difficult.

5.2 The use of price controls in post was extensively considered and rejected in the Hooper reviews in 2008 and 2010. We support Ofcom's view of the pre-2012 regime – that extensive price controls were not effective in ensuring Royal Mail improved efficiency; did not prevent price rises; and worsened the situation regarding sustainability. The following sections provide further reflections on the Postcomm regime.

Lessons from the Postcomm experience

5.3 Royal Mail was previously subject to stringent price controls under Postcomm. The Postcomm regime was introduced when the postal market was first liberalised and was still growing.

5.4 However, even with this background, Postcomm's regulatory approach went significantly beyond the requirements imposed by the European Postal Services Directive and the Postal Services Act 2000 which was applied at that time. Royal Mail was constrained by a broad and stringent set of rules governing every part of its operations – pricing, product introduction, customer and competitor communications, quality of service (QoS) targets and information provision.

5.5 When the PSA 2011 was introduced, the intention of Government was to give Ofcom the relevant powers to address the challenges facing Royal Mail, to minimise regulation wherever

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possible, and to ensure that the Universal Service provider, Royal Mail, was given the necessary financial, operational and commercial flexibility to deliver the Universal Service in what was clearly a declining letters market. The PSA 2011 explicitly acknowledged the importance of the financial sustainability of the USO including the need for the Universal Service Provider to be able to make a commercial rate of return. In its March 2012 statement, Ofcom recognised that price controls implemented by Postcomm had not been successful, stating:

- "*When the last full price control was implemented by Postcomm in 2006, market volumes were expected to broadly flat for the period of the control. Instead, UK market volumes have fallen by over 25% as consumers have moved away from traditional mail and towards digital means of communication. As volumes have dropped, Royal Mail's average unit costs have increased.*"[116]

- "*Within this context of a declining postal market, the current "traditional" price control has not been successful in incentivising efficiency improvements and securing the provision of the universal service.*"[117]

We agree with the reasons Ofcom sets out for not opting for the other price control options raised in chapter 5 of the CFI

5.6 In its CFI, Ofcom acknowledges stakeholder concerns with rising prices and poor QoS but also the issues Royal Mail is facing such as structural decline in the letters market and financial sustainability issues. It sets out a number of alternative approaches, namely:

- profitability cap;
- cost-based charge control;
- pre-authorisation regime; and
- outcome incentives.

5.7 We agree with and welcome Ofcom's statement in paragraph 5.9 that " *[Ofcom's] initial analysis suggests that, taken as a whole, these options do not offer clear advantages over our current approach to price regulation, …….*"

5.8 As Ofcom set out there are challenges with all these approaches, particularly with regard to the postal market that we operate in. We agree that there are many reasons that other price control options are undesirable and likely to repeat the errors of the Postcomm era.

Letters are in structural decline and any form of price control could undermine the financial sustainability of the USO

5.9 As Ofcom acknowledges, we have not made a commercial rate of return since 2015/16. We have had no option other than to implement higher price increases than we might otherwise have chosen to do. However, with a more stringent price control in place, this action may not have been possible, putting the provision of the USO in even greater jeopardy over recent years.

5.10 Royal Mail has faced significant market challenges over the past few years. The current safeguard cap is one of several factors that impact the financial sustainability of the USO. Significant e-substitution and risk of hitting tipping points means we have to consider very carefully any price increases. Combined with the structural decline in letter volumes and high fixed costs associated with delivering a six day letter service to every address in the UK, the safeguard cap puts increasing strain on the financial sustainability of the USO and our ability to maintain a market funded USO.

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5.11 We need the flexibility to react to market dynamics in pricing and product innovation. Any regulatory framework should include sufficient flexibility and adjustment mechanisms to allow for rapid change to help secure the future of the universal postal service. Ofcom recognised this in its 2012 decision on the regulatory framework, noting that one of the key justifications behind removing the substantial majority of price regulation was because "*Royal Mail rather than Ofcom is better placed to determine how and what price increases should be applied*."[118]

5.12 Our network was set up for letters. The parcel market is growing and we need to focus on remaining competitive and bringing profitable revenues from parcels need to be the driving force behind future growth. However, the transition to a more parcel focussed business is not something that can happen quickly. We also need to manage this transition against a continuing backdrop of ongoing letter decline. This tension is exacerbated by the fact that the parcels market is highly competitive. To compete successfully, we need to invest in new technology and ways of working. However, our ability to invest goes hand in hand with a sustainable letters service. The recent changes to the USO regulations are an important first step in improving the sustainability of the USO.

5.13 Whilst letters are in structural decline, they still have a future with the right innovation. We have invested in keeping letters relevant wherever our finances have allowed. For example, in 2014/15 we made a £595m profit[119] and invested £70m in Mailmark – a barcoding technology for letters. This has created a wide range of benefits for our customers, including detailed reporting of the performance of their mailing, and has also benefited Royal Mail through automated revenue protection which ensures we get paid fairly for the work we do.

5.14 Future investments are however dependent on our financial position and in recent years we have had to postpone key investments due to this. We need regulatory flexibility to ensure we can earn sufficient margin to fund future investment which will benefit our customers through a mix of efficiency improvements and service enhancement. Given our role providing critical national infrastructure, this would also support productivity in the economy more widely.

5.15 Prior to USO reform, price was one of the few levers available to us to manage our financial position. Whilst we have now greater operational flexibility, and we are working with our unions to implement this, we need to retain pricing flexibility to ensure we can raise the revenues required to fund the cost of the USO network. Additional price controls would undermine this flexibility.

Efficiency targets forming part of any price control are unlikely to be met and are likely to promote perverse outcomes

5.16 Royal Mail operates in a market of declining letter volumes and changing product mix which makes pursuing efficiencies more difficult. In a growing market, efficiency can be achieved by not putting new costs into the business. In a declining market, cost needs to be taken out. This is even more challenging in a company with high fixed costs mainly relating to delivery staff and the requirement to provide the USO. In the short-term, these staff will still need to cover the same routes regardless of whether volume has declined. To remove these costs takes time and results in a number of challenges.

5.17 When volumes decline, the company must actively work to remove surplus capacity from the business – for example, by reducing staff hours, the number of staff, or redesigning routes. These measures take time to implement and there is a lag between falling volumes and removing costs. These changes are also more difficult to enact in a highly unionised workforce as is the case in Royal Mail.

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Rather than tightening regulation of pricing in Access, Ofcom should consider removing or making changes to the regulatory margin squeeze control (USPA6)

5.18 Ofcom has acknowledged that the Access market is working well. In its Post Monitoring Report 2023-24, it stated that "*Annual Access bulk mail continued to represent the majority (70.7%) of letters sent in 2023-24 (4.7 billion items), with its share of volumes increasing by 0.3 percentage points in 2023-24. Overall, Access bulk mail volumes declined by 8.6% year-on-year, while Royal Mail end-to-end addressed letter volumes stood at 1.9 billion*". This demonstrates the retail bulk mail market is highly competitive and Access providers are doing well. There is no evidence that the situation is changing and Access providers are losing market share to Royal Mail Retail. In fact, it is the contrary; Royal Mail Retail's share of a declining letters market continues to fall.

5.19 We agree there is no evidence to support widening the test to include unsorted – the upstream market for bulk letters is competitive. Ofcom looked into this as part of its consultation on USO reform. In its decision document it stated that "*Both Royal Mail and access operators have roughly equal market shares of unsorted mail within the total bulk mail market. Those shares have remained stable in the last six financial years, suggesting that Royal Mail is not winning unsorted mail volumes from access operators*".[120]

5.20 It goes on to say "*The stability in market shares does not support the argument that Royal Mail pricing is having an exclusionary effect as, even if profit margins are narrow, or narrower than in sorted mail, access operators appear to be competing effectively*."[121] This position is not changing. In fact, the current regulatory margin squeeze test (USPA6) is now hindering competition. Royal Mail Retail cannot compete on a level playing field as the regulatory margin squeeze test does not use the appropriate cost metrics that would apply to a multi-product firm in a competitive market. As volumes decline and our share of the bulk mail letters market declines, it pushes up our unit costs for those services. The effect of this is to accelerate our inability to compete and therefore reducing competition overall. This is repeating the problem from the Postcomm era where inappropriate cost metrics were used in margin squeeze tests significantly reducing the ability of our Retail Letter business to compete. Increasing the number of baskets – one for each service – as Ofcom suggests will only serve to make this worse. Lower volume in each basket means, if current cost metrics are maintained, it is more likely we will need to cover full fully allocated cost (FAC) not just 50% FAC for every contract or service. This will lead to higher prices and less choice for customers.

5.21 Whilst we do not support the widening of USPA6 or Ofcom's suggestion of multiple baskets, we do believe Ofcom should consider making changes to the regulatory margin squeeze control (USPA6).

5.22 USPA6 is no longer necessary for the continuing functioning of a competitive upstream letters market – by Ofcom's own admission the upstream market is working well. However, if USPA6 is to be retained, Ofcom should consider reforming USPA6. It should consider modifications to the cost metrics which would benefit customers by facilitating increased competition for large bulk mail contracts.

5.23 We believe the cost metrics used in USPA6 should be revised to reflect Royal Mail Retail's incremental cost, rather than FAC. This would not harm competition, since it would still allow an equally efficient operator to compete, but it would allow Royal Mail Retail to offer lower prices as our Long Run Average Incremental Cost (LRAIC) for the relevant services is below the 50% FAC proxy that Ofcom has imposed since 2012. This would be beneficial to customers as it would increase competition and drive prices down further.

5.24 We would welcome the opportunity to engage further with Ofcom on understanding our upstream costs with the aim being able to make some improvements to USPA6.

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6. A forward-looking framework will ensure change is managed effectively for customers

Key messages:

- **Royal Mail, Ofcom and Government each have different but important responsibilities in ensuring the future of the USO through collective, proactive stewardship.** With structural letter decline set to continue – but its pace uncertain – it is important to take a strategic long-term approach to future regulatory reform. We must look to the future and set out a clear framework for dialogue and responsibility, so that issues can be addressed in an effective and timely way.
- **All stakeholders, including Royal Mail, would benefit from greater clarity on how further USO reform, whether through regulatory or legislative change, will be approached.** With modest changes, the current monitoring framework can be made more forward-looking and effective. Ofcom has said that "*it is incumbent on Royal Mail to proactively identify and notify us of financial sustainability concerns*". [122] Our proposal sets out how we intend to do this.
- **We propose a strategic, structured approach centred on an annual senior-level meeting between Royal Mail and Ofcom to review and discuss the financial sustainability of the USO (checkpoint 1).** This 'health check' would foster a shared understanding and improved regulatory dialogue, with outcomes reported to Government.
- **We propose two further checkpoints in the framework and we would welcome Ofcom's view on their suitability: (checkpoint 2)** If there is an issue, Royal Mail could assess whether to undertake financial analysis to support a net cost calculation of the USO, similar to Ofcom's previous analysis, and Ofcom could consider doing likewise; and **(checkpoint 3)** Royal Mail would submit a report to Ofcom and shared with Government outlining our assessment of financial sustainability, the net cost of the USO and one or more alternative proposals that meet customer needs whilst reducing financial burden.
- **Finally, we set out various further regulatory changes that Ofcom should consult now to enable us to be more responsive to changing needs and drive efficiency.** These include removing the prohibition on tracking of USO parcel services and allow the introduction of an additional Special Delivery end of day product within the USO.

Safeguarding the future of the Universal Service through collective stewardship by Royal Mail, Ofcom and Government

Royal Mail, Ofcom and Government all share responsibility for the continued provision of the USO

6.1 Together, Royal Mail, Ofcom and Government have a mutual and collective responsibility for the stewardship of the USO and for its continued provision, and each of us plays a role in guiding the evolution of the USO:

- **Royal Mail's role** is, as Ofcom has stated in relation to financial sustainability, to "*proactively identify*" concerns to the financial sustainability of the USO;
- **Ofcom's role** is to assess, consult and decide on changes within its control, or to recommend to Government for legislative change; and

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- **Government** can introduce new legislation or amend existing legislation, if it decides to do so.

6.2 We are fully committed to provide a USO that meets customer needs and adds significant value to UK society. It is also incumbent on us to assess the level of risk and cost associated with the provision of the USO and what actions can be taken to mitigate this.. We consider it to be good corporate governance to proactively review the risks to the financial sustainability of the USO.

As structural decline in letters continues, it is essential to know when it is likely to become necessary for further timely regulatory change

6.3 Royal Mail is operating against the backdrop of a continuing structural decline in letter volumes, which fundamentally changes the economics of delivery (as set out in chapter 2). The direction of this trend is certain, but its pace is uncertain. Ofcom and Government both have a role in ensuring that the regulatory and legislative framework is and continues to be supportive of the sustainability of the USO.

6.4 It is therefore very welcome that Ofcom made changes to the USO in July and is now looking for a more targeted approach to address Ofcom's concerns relating to the limited affordability issues facing some customers. However, given that structural decline is set to continue, it is important that Ofcom takes a holistic view of what is appropriate for postal regulation in future, considers some specific further changes in the short term, and puts in place a framework that facilitates an informed and honest conversation about the sustainability situation and the need for further reform.

6.5 Such a framework will allow Royal Mail, Ofcom and Government to address sustainability issues ahead of time, but also to clearly delineate accountability and the relevant roles of each party.

6.6 The rest of this chapter provides further detail on the following points:

- Ofcom and Government have a role in enabling future USO reform;
- there is a need for greater clarity on how future USO reform will take place given that change can take years;
- we propose a more strategic and structured approach; starting with an annual senior meeting between Royal Mail and Ofcom on the financial sustainability of the USO;
- if issues are identified, then Royal Mail may undertake analysis to support a net cost calculation (Ofcom may decide to do so too) and provide a report to Ofcom and Government setting out the need for change and potential options for change; and
- lastly, there are further regulatory reforms that could be undertaken now that continue the deregulation agenda Ofcom started in 2012, enabled by the PSA 2011 and would have the benefit of delaying further more significant USO reform.

Ofcom and Government each have a role to play in future USO reform to ensure the continuation of a universal postal service

6.7 There is a role for Ofcom, and Government, in the consideration of future regulatory change. This current wave of USO reform are changes within Ofcom's control including the introduction of more targeted support in place of the current Second Class safeguard cap. In terms of further change, Ofcom has stated that "*Our view remains that it is unlikely we can do significantly more under the current regulatory framework to respond to the challenges facing the universal service. As the letter market continues to decline, it may become necessary to review the specification of the universal service again in the future, although we note that any further substantial changes would likely require amendments to legislation.*"[123]

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6.8 There are a range of further regulatory changes, set out in the table below. Further regulatory change remains in Ofcom's gift in terms of replacing the Second Class safeguard cap, changing QoS performance targets, removing outdated regulatory restrictions such the prohibition on tracking of USO parcel services. Other significant changes, such as delivery days or uniformity, will require either primary or secondary legislation.

Figure 6.1 – Main areas of regulatory change with Royal Mail, Ofcom and Government's respective roles

Change	Ofcom role	Government role	Legislative change
Second Class safeguard cap reform / QoS performance targets / Tracking on USO services / Special Delivery changes	Consult and decide	Informed by Ofcom	N/a
Delivery / collection days	Consult and recommend to Government	Agree and draft change, and debate	Secondary legislation
Key requirements of USO (e.g. geographic uniform tariffs,)	Consult and recommend to Government	Agree and draft change, and debate	Primary legislation
Royal Mail's role is to highlight potential financial sustainability issues then review and assess different change options to identify potential solution(s) to feed into Ofcom and Government.			

Ofcom's powers

6.9 Ofcom has a number of levers within its control. These include:

- **Second Class safeguard cap and not widening price controls.** As we have set out in earlier chapters, there is an opportunity for Ofcom to replace the Second Class safeguard cap with a more appropriate targeted scheme and widening of price controls would threaten the our ability to provide the USO;
- **changes to Quality of Service (QoS) performance targets**. Ofcom has recently updated some QoS targets in its July 2025 decision;
- **prohibition on tracking of USO parcel services.** As we explain later in this document, we consider that this prohibition is out of date and should be removed; and
- **Special Delivery without time restriction**. This is a further change that is within Ofcom's control.

Changes will take time and legislative changes are likely to take several years

6.10 The table below sets out indicative timelines for further regulatory reform.

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Figure 6.2 Indicative time it would take to deliver further reform to the USO

Type of change	Ofcom's role	Government role	Indicative time required
Within Ofcom's control	Consult and decide: 12-18 months[124]	Informed	12-18 months
Secondary legislation	Consult and recommend: 12-18 months	Develop policy; draft statutory instrument; secure parliamentary procedures	Two years
Primary legislation	As above	Develop policy options; finalise policy; draft new legislation; bill passage	Three years

6.11 In summary, certain reforms – such as adjustments to QoS performance targets – fall with Ofcom's existing powers. More substantive reform to the core constructs of the USO, however, would require legislative changes and is likely to take significantly longer.

International comparisons support ongoing change to the USO

6.12 The table below sets out the common areas of regulatory change for other European postal operators. The most common changes have been to frequency of delivery and quality of service.

Figure 6.3 – Types of USO reform over time[125]

Frequency of delivery	Reduce from 6DW to 5DW	Denmark, Netherlands, Norway
	Limit application of 5DW	Belgium
	Flexibility to reduce from 5DW	Finland
	Flexibility for alternate day in certain areas	Italy
	Introduction of alternate day	Finland, Norway
Quality of service	Reduced QoS requirements	Belgium (x2), Denmark, Finland, Germany
	Removal of D+1 requirement	Denmark, France, Germany, Norway, Sweden
Point of delivery/access	Allow automated access points	Germany
	Reduced requirements for access points	Netherlands
	Position of residential mail boxes	Denmark, Sweden
	Delivery to service point	Finland
Definition of USO	Removal of direct mail	Italy
	Removal of bulk parcels/mail	Belgium, UK
	Removal of outbound non-prior	France
	Discontinuation of USO	Denmark
Other/consultations	Post as part of wider communications market	Netherlands
	Transfer of responsibilities from USP to NRA	Norway
	Removal of D+1	Netherlands
	Delivery to service point	Norway
	Sustainability of USO	Netherlands, Spain, UK

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6.13 What we have also found is that USO reform is not a one off, whereby making a change removes once and for all the need for ongoing review and reform. It is a journey reflecting that letter volumes are in structural decline. The table below shows a decade of USO reform across comparative European countries.

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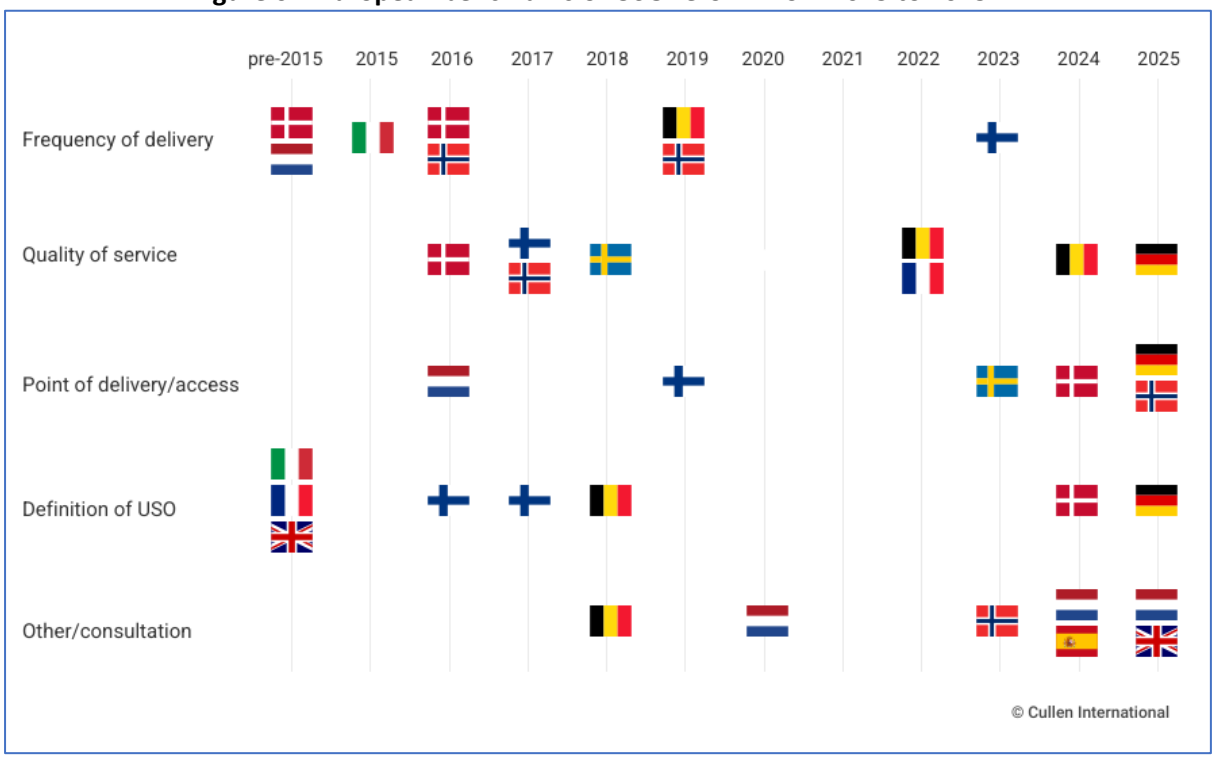
Figure 6.4 European bencmarks of USO reform from 2015 to 2025[126]



6.14 When changes in other European countries have been delivered, it has also tended to take time – many years – for this to be delivered. For example, Deutsche Post called for USO reform in October 2019[127] and it took until July 2024 for a new postal law to be approved[128] with the new law coming into force on 1 January 2025.

All stakeholders, including Royal Mail, need greater clarity on when the USO needs to be reformed and how

6.15 We need to know well in advance when the financial sustainability of the USO is at risk as potential remedies could require regulatory change which requires public consultation or even lengther primary and/or secondary legislative change.

The catalyst for USO reform should not be sustained losses for Royal Mail

6.16 The figure below articulates a simplified overview of the last five years' activity in relation to USO reform by Ofcom and by Royal Mail. We have been calling for USO reform from 2020. In November 2022, following the end of COVID and a dramatic reduction in parcel volumes, and facing into a series of damaging strikes, we called for five day letter delivery USO reform. This was a change that could be expedited quickly to help the financial sustainability of the USO.

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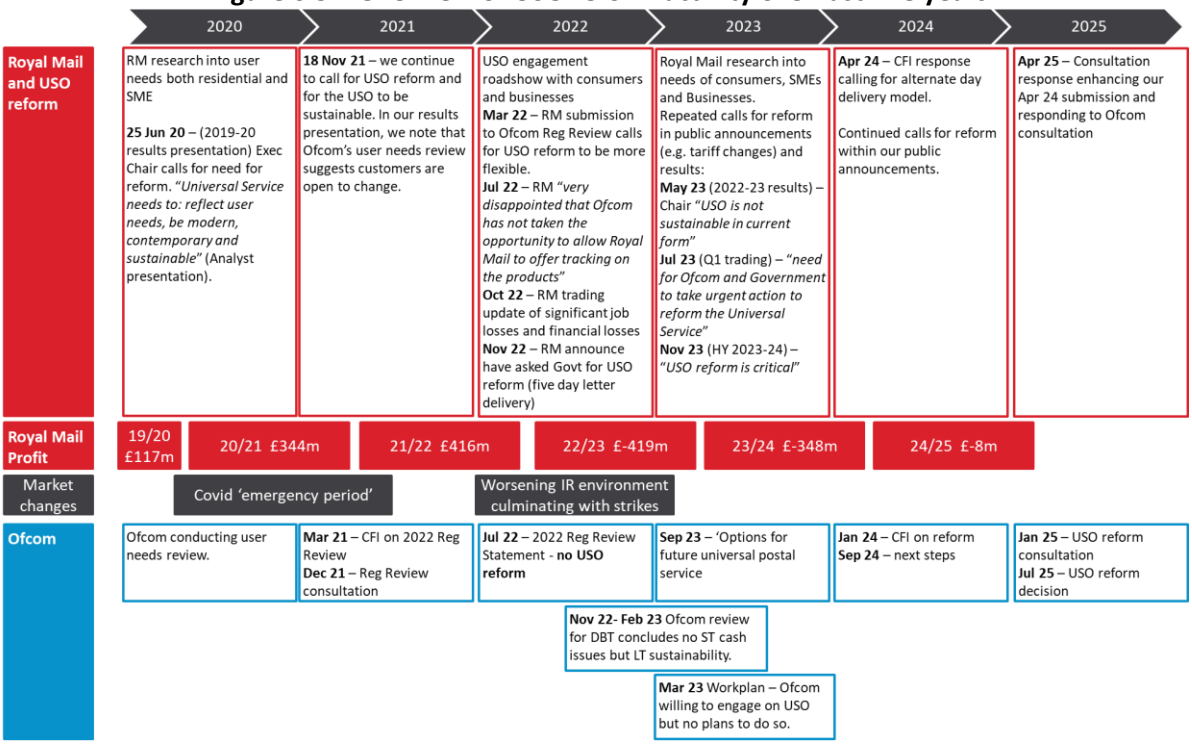
Figure 6.5 – Overview of USO reform activity over last five years



6.17 We welcome that, by September 2023, Ofcom had decided to initiate a review that culminated with measured changes to the USO that better meets customer needs and helps to address financial sustainability. However, the catalyst for such a review should not be sustained losses for Royal Mail – that is not good for customers nor other postal stakeholders. Stakeholders need to understand that the postal USO can evolve in a timely manner rather than only changing if the USO is facing a cliff edge of financial viability.

6.18 The postal sector needs a forward-looking regulatory framework to know when further regulatory reform is required to ensure timely and coordinated delivery of change to benefit consumers and other postal stakeholders. From our recent experience, through engaging with Ofcom's process for reform, undertaking comprehensive customer research and a detailed operational and financial review, we concluded that an alternate day delivery model would be the most appropriate reform that balanced customer needs and financial sustainability. It is important that the process to assess the financial sustainability of the USO has time for this careful consideration of options. So, it is a case of looking forward to knowing when further reform is necessary and having enough time to work out what that reform should be.

We propose a more strategic structured approach

6.19 In February 2023, Ofcom's regulatory financial reporting framework changed to require an annual five year financial forecast, with the first forecast provided to Ofcom in June 2023. Ofcom recently explained that it had increased its "*monitoring activities and focussing further on the areas which we consider carry a higher risk than before, including the cash position of Royal Mail and continued financial support from IDS.*"[129] Ofcom explained that "*these monitoring activities collectively comprise an adequate early warning system*".[130]

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6.22 We are concerned that Ofcom's recent increase in monitoring addresses short-term viability concerns (e.g. current year performance on cash flow) rather than long-term sustainability (forecasts on EBIT margin). A company is not viable if it cannot pay the bills. When a company faces viability concerns, a company may find it difficult to refinance its debt and risks financial collapse. A company is not financially sustainable if it cannot earn a commercial rate of return (as set out in the PSA 2011) that enables it to invest and innovate and also pay its debt and equity investors a fair return for the risks they are taking in investing in a business. Royal Mail has not earnt the minimum floor of Ofcom's indicative commercial rate of return since 2015/16.

6.23 That said, Ofcom's new monitoring framework requires a five year financial forecast that provides a view of the future EBIT margin for the Reported Business, along with a requirement to provide sensitivities and downside analysis. This is to be provided annually. This is the backbone of Ofcom's financial sustainability framework, and with some modest enhancements, it can be used to provide a strategic, forward-looking view. We also believe these enhancements are consistent with the Government's recent policy paper that set out a "*New approach to ensure regulators and regulation support growth*".[133] In particular, the Government has identified a need to "*reduce uncertainty across our regulatory system*" and to have "*clear processes and published timelines for decisions*".[134]

6.24 In making our proposal, we are addressing Ofcom's view that "*in addition to our monitoring regime, it is incumbent on Royal Mail to proactively identify and notify us of financial sustainability concerns. It is for Royal Mail to explain its vision of how the business needs to develop over time to ensure the universal service is financially sustainable. Our regulations require Royal Mail to provide us this vision, in part, in the form of annual financial forecasts required under our regulatory reporting framework. We also expect Royal Mail to provide us (and the Government) with information about any concerns, together with proposals to address those concerns, in sufficient time and in a responsible fashion.*"[135]

6.25 What we set out in our proposal is how we intend to "*proactively identify*" financial sustainability concerns and how this would work alongside Ofcom's existing framework.

Our proposal to proactively identify financial sustainability concerns leveraging off Ofcom's existing regulatory financial framework

6.26 Our proposal leverages Ofcom's current framework and overlays three changes to that framework, building checkpoints into the process:

- checkpoint 1 – an annual review meeting between relevant members of Ofcom's Senior Management Team and Royal Mail's CFO. This is an important step to foster a common understanding of the financial sustainability of the USO – a 'health check' on the USO. We

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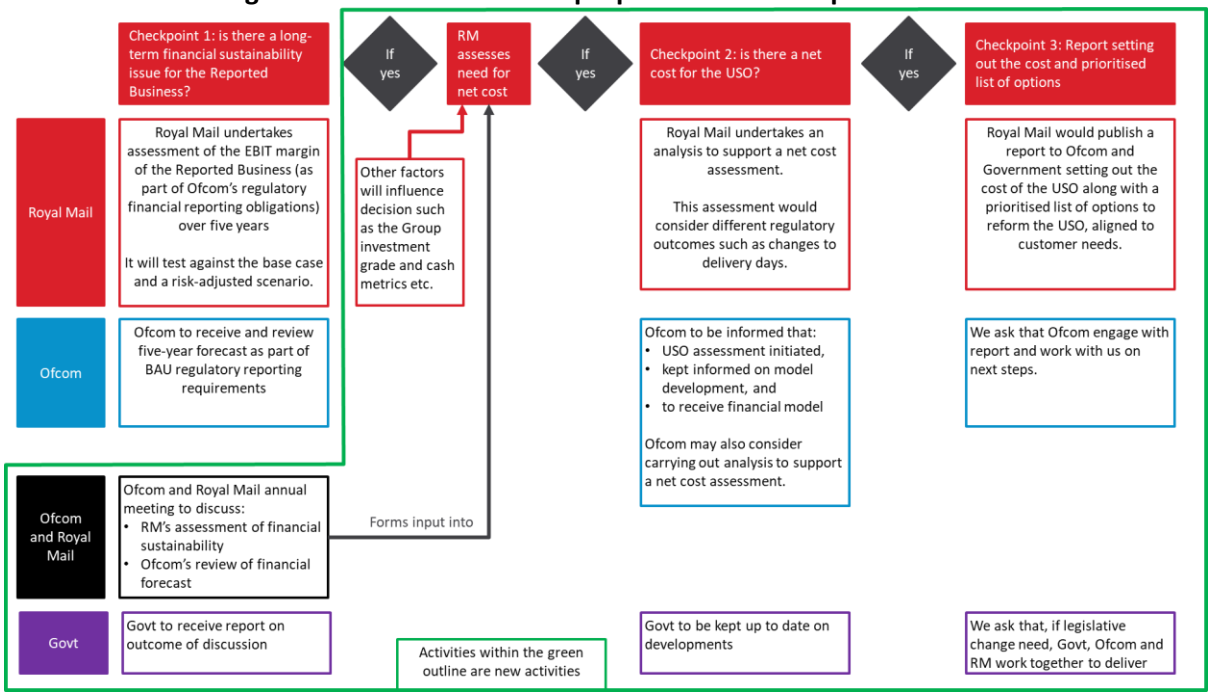
consider this to be critical to creating a better regulatory dialogue between Ofcom and Royal Mail and would strongly encourage Ofcom to agree to this part of our proposed framework. We believe that there are two further checkpoints that make sense as part of the framework, and we would welcome Ofcom's perspective on what would make most sense;

- checkpoint 2 – if there is, then Royal Mail considers undertaking analysis to support a net cost assessment (and Ofcom could consider carrying out such an exercise); and
- checkpoint 3 – a report by Royal Mail to Ofcom and Government setting out our assessment of the financial sustainability, the net cost of the USO and one (or more) proposals for further USO reform that meets customer' needs and reduces the financial burden.

6.27 We believe that our proposal – that reflects USO reform is a collaborative and joint activity – is consistent with Ofcom's view of USO reform. Should there be a financial sustainability issue, Ofcom has stated that "*If, having concluded any assessment, we determined that some form of response was necessary, the appropriate response would depend on the underlying cause of the problem. For example, the response to a deterioration in the returns made caused by structural change in postal markets is likely to be different to one caused by delays to the delivery of efficiency improvements. We also recognise that some responses that might appear helpful in theory could have unintended consequences in practice. We would therefore expect to work with Royal Mail to better understand which responses are most likely to be effective, and those that might be unhelpful.*"[136]

6.28 This framework is shown in the figure below with the activities in green being an enhancement to the current reporting activities. Our proposal is a 'light touch' amendment to the framework, requiring as a minimum an annual senior-level meeting between Royal Mail and Ofcom, and for Royal Mail to consider whether there is a need to undertake analysis to support a net cost assessment. Only if we decide it is right to undertake that calculation is there a material increase in activity.

Figure 6.6 – Overview of the proposed stewardship framework



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Checkpoint (1) Annual review meeting between Ofcom and Royal Mail in relation to the annual five-year forecast

6.29 This meeting is at the heart of our proposal for a more strategic and structured approach. We see this as a minimum requirement for an effective regulatory dialogue between Royal Mail and Ofcom.

6.30 Within Ofcom's financial reporting requirements, there is a requirement to provide a five year financial forecast for the Reported Business, along with sensitivities and scenarios. Our proposal is that we would use the information in this existing process to assess the long-term financial sustainability. This financial submission to Ofcom already includes a base case with upside and downside sensitivities. As part of this submission, we also consider one (or more) risk-adjusted scenario alongside the base case. Our base case will include management ambition and challenge which may not come to pass. A risk-adjusted scenario would be a more prudent set of financials that would make plausible adjustments to the base scenario to ascertain an alternative and possible outcome. We have provided this annually since 2023 when Ofcom's new regulatory reporting framework was put in place.

6.31 The key metric that we would use to ascertain financial sustainability is the Reported Business EBIT margin. Ofcom has stated that this is a long-term metric that supports the financial sustainability of the USO.[137]

6.32 We provide Ofcom with significant detail on our financial forecasts. However, currently there is limited dialogue between Ofcom and Royal Mail in relation to these financial projections. We believe a two-way dialogue would be very helpful. We envisage a meeting between Royal Mail's Chief Financial Officer (CFO) and Ofcom's Senior Management Team (SMT). This provides an opportunity for the Royal Mail CFO to set out our view of the business, along with the risks and opportunities and, in return, for the relevant members of Ofcom's SMT to set out their assessment of the financial sustainability of the Reported Business. This senior-level exchange of views and insight would be hugely beneficial in seeking a common view on the financial sustainability of the USO, and the best way forward on issues.

6.33 The output from these discussions – which we have described as being like a 'health check' – could help inform Royal Mail (and potentially Ofcom) whether to initiate a review of the net cost of the USO. Understanding whether Ofcom has concerns on the financial sustainability of the USO as well as its thinking as to the potential challenges would be a valuable input into whether to undertake a net cost calculation.

6.34 As we have set out, the USO is under the stewardship of Royal Mail, Ofcom and Government. It would be helpful for Government to be sighted on the key outputs of the dialogue between Royal Mail and Ofcom , and we propose that a report is provided to Government as an outcome from this ongoing engagement dialogue.

Checkpoint (2) Royal Mail decides whether to test if there is a long-term financial sustainability issue for the Reported Business (and Ofcom may wish to do so too)

6.35 As set out above, we consider that the annual senior-level meeting is critical to creating a better regulatory dialogue. We think that there are two further 'checkpoints' that follow naturally – but we would welcome Ofcom's perspective on the best approach and note that further action could be decided upon during annual review meetings.

6.36 From the output of Royal Mail's business planning, the meeting with Ofcom's SMT and other relevant inputs such as a change to the investment grade of IDS Limited and/or cash metrics,[138] Royal Mail could consider whether there is a need for analysis that would support a net cost calculation. We believe this decision will be subjective as consideration will need to be made in

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relation to the financial base case as well as the risk-adjusted scenario(s) – it is not a 'hard-wired' outcome to a particular scenario / range of metrics.

6.37 For the avoidance of doubt, the net cost calculation we propose is not intended to be a formal assessment as set out in Section 44 of the PSA 2011. A calculation for these purposes would typically inform and / or set a subsidy. It is not the purpose of this exercise. It is an estimate of to what extent Royal Mail, if it were not the USP, would be financially better or worse off, looking out over a five year period. Ofcom undertook a similar exercise in 2024 (but based on historic information) when it estimated that "*complying with the USO could give rise to a significant net cost to Royal Mail in the region of £325-675m*".[139] This was a helpful and instructive exercise that provided publicly an estimate of the financial burden that the USO placed on Royal Mail.

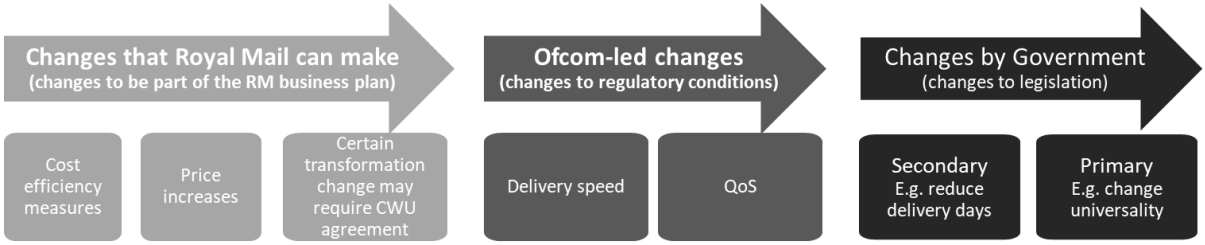
6.38 Moreover, as part of this net cost exercise, we need to take a view as to what are the optimal changes to the future USO that continue to meet customer needs and improve financial sustainability. As we have stated throughout our submission, USO reform is a journey that has started with alternate day delivery for non priority mail and, we hope, will shortly replace the Second Class safeguard cap with a targeted scheme that would protect vulnerable customers and provide cheaper post for households who need it most. Looking further ahead there are a range of options for future regulatory reform and we see the net cost exercise as a helpful tool to identify what comes next.

6.39 The net cost calculation and supporting analysis can be used to:

- identify what is the net cost of being the USO provider; and
- identify the impacts of potential USO changes, including when these changes could be initiated.

6.40 This analysis would consider all options for change. The diagram below sets out the options including how difficult and complex change can be. As we move from left to right on the chart, the degree of complexity increases and governance changes.

Figure 6.7 Illustrative spectrum of options for changes to the USO



6.41 We will engage with Ofcom throughout this assessment process, keeping them up to date on our modelling.

Checkpoint (3) Report by Royal Mail on financial sustainability, net cost burden and alternative configurations of the USO

6.42 If our financial modelling concludes that there is net cost (and having already determined that there is a financial sustainability issue for the USO), then we propose that Royal Mail provides a report to Ofcom and Government that sets out:

- there is a financial sustainability issue for the USO;
- there is a net cost of being the USO provider; and

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- one (or more alternative) proposals for the USO that meets customer needs and reduces the financial burden.

6.43 We would ask that Ofcom and Government work with us on next steps. Once we have engaged with Ofcom and Government in meaningful dialogue, we can consider what information is necessary to be published to all stakeholders to set out the case and choices for further proportionate regulatory reform. Clearly, proposals which consider a change to the current USO would need to be tested with customers at an appropriate stage in the process to ascertain whether the alternative proposal would continue to meet customer needs.

Further regulatory changes that Ofcom should consult on to ensure we can respond rapidly to changing customer needs

6.44 We have identified several important areas for regulatory reform that will benefit customers and potentially delay further more significant USO reform. Our ask is that Ofcom includes this in its consultation. We address these in turn:

- **Fulfilment (General) Large Letters** are small parcels and should be removed from the access mandation. Ofcom has recognised that the supply of parcels is highly competitive;
- **remove the prohibition on Tracking on parcels in the USO**. Current regulatory restrictions prevent Royal Mail from offering tracking on USO parcels. This excludes consumers from essential delivery information and innovation. This undermines the relevance of the USO; and
- **Special Delivery End of Day.** We believe replacing the Special Delivery 1pm service with a Special Delivery End of Day service will save significant costs that would otherwise need to be passed onto consumers.

Fulfilment (General) Large Letters are parcels and should not be mandated

6.45 The USP Access Condition should be updated to remove the requirement that we have to accept all types of large letter items in Access, including fulfilment large letters (called General Large Letters in Wholesale), which are effectively parcel type items. As currently drafted, the USP Access Condition simply defines a large letter by reference to its size and weight characteristics, and does not exclude large letters which contain goods (e.g. fulfilling a purchase made online). We consider this approach is outdated, does not reflect current market reality and distorts competition. The Condition should be updated to carve out fulfilment items from the access requirement, so that we only have to accept letter or large letters which contain correspondence, publications or other documents.

6.46 By way of reminder, we made this request to Ofcom as part of the 2022 Regulatory Review. The evidence to support our request is even stronger now. In particular:

- as Ofcom will be aware, competition in the parcels sector is even more intense now than in 2023, with end-to-end operators competing fiercely for all types of parcel services, including smaller parcels that fall within the dimensions of a large letter. Our share of supply has fallen significantly across all segments including for these types of parcels;
- Access operators, such as UK Mail, which is now part of the DHL/Evri group, have their own parcel delivery activities and are in no way reliant on Royal Mail for the delivery of smaller parcel items that fit through a letterbox;
- Access operators which do not have their own delivery networks, such as Whistl and TDG, can and do easily contract with a range of other end-to-end parcel operators for the delivery of these items. They are therefore not reliant on Royal Mail Wholesale for delivery of these items either; and

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- this is reflected in the number of fulfilment large letter items which are now carried in Royal Mail Wholesale, with fulfilment large letter volumes declining from [✂] per annum in 2020/2021, to only [✂] per annum in 2024/25, and are expected to fall significantly more in the coming years.

6.47 Ofcom was minded to make the change we requested as part of its 2022 Regualtory review, but had residual concerns around the ability of customers such as banks, who predominantly send documents (such as statements, notices on interest rate changes etc.) but who occasionally send other items, such as card readers, to 'multisource' and sometimes prefer a single supplier. For the reasons explained above, Access operators can now easily source parcel services from third parties (including Royal Mail Retail, as well as other operators) and so this concern is no longer likely to be relevant.

6.48 We therefore ask Ofcom to examine this question again, and consider limiting the access requirement to correspondence, publications and other documents and carve out parcel type items. Continuing to mandate parcel items in access is outdated, places unfair obligations on Royal Mail, and distorts the highly competitive parcels sector without any discernible consumer benefit.

Modernise the USO by removing outdated regulatory restrictions which prohibit tracking on USO parcel services

6.49 Ofcom has prohibited the inclusion of tracking on USO parcel services since it took over postal regulation in 2012, citing that it believes allowing tracking on USO services could be damaging to competition.[140]

6.50 Ofcom's view appears to be that we have an advantage over other parcel operators as a result of the VAT exemption for USO services and so this exemption should apply to the most basic of parcel services. However, this view is misconstrued. We do not have an advantage. Crucially, there are significant costs to us in meeting the USO requirements for parcel services which are not borne by other parcel operators. The supply of consumer parcels in the UK is highly competitive and rapidly evolving. In any event, the VAT exemption is clearly having little impact on competition as the parcel market is offering ever greater consumer choice, for example:

- many Post Office branches now offer parcel services on behalf of Evri, DPD, DHL and Amazon;
- extensive deployment of locker networks, including by InPost, Quadient, Yeep!, and Amazon; and
- development of parcel PUDO networks in retail outlets, including by Evri, Collect+ and Amazon.

6.51 The prohibition on tracking on parcels in the USO harms consumers. Tracking has become a hygiene factor that consumers expect. Ofcom's own research shows that the service improvement most consumers would want to see is "*more / better tracking information*".[141] Ofcom's position of prohibiting tracking on USO parcel services is at odds with what consumers are demanding.

6.52 Royal Mail believes that Ofcom should relax the outdated restrictions contained within the DUSP conditions [142] that prohibit Tracking on First and Second Class USO services and should do so within the scope of its current review. This would allow Royal Mail the necessary commercial flexibility to determine the specification of USO parcel services as the parcel market continues to develop, without having to wait for Ofcom to conduct a separate lengthy regulatory review process. We would welcome further dialogue with Ofcom on this topic.

Classified: RMG – Public

Special Delivery End of Day

6.53 Ofcom's DUSP condition requires Royal Mail to provide registered and insured service(s) with a target delivery time of 1pm, except where this is not reasonably possible.[143] Royal Mail provides this through our Special Delivery 1pm service. This goes beyond what is required by the PSA 2011, which requires registered and insured services,[144] but does not require that these be delivered by 1pm.

6.54 This 'one-size-fits all' approach is unnecessary. Royal Mail needs the flexibility to offer delivery times that are convenient for both our customers, whilst also being workable within our operation at reasonable cost.

6.55 To better meet customer needs, and optimise operational efficiency, Royal Mail has changed the time that deliveries start. This has enabled us to accept parcels into our network later which both allows more next day delivery whilst also reducing our reliance on costly air conveyance to achieve this. We will also be deploying an alternate day delivery model as part of USO Reform – this is crucial to reducing the cost of delivering an ever-declining volume of letters to an ever-increasing number of addresses. On the 'combined' routes, these will be longer and cover more delivery points than our current routes so this will lead to more diversions and that these diversions will take longer. The combination of these two changes (network window and alternate day delivery) mean that it has become more expensive to provide a Special Delivery service with a 1pm delivery time and that we expect the cost to increase in the future. Allowing later delivery timeframe would be both less costly and more reliable.

6.56 We propose Ofcom allow the introduction of an additional Special Delivery end of day product within the USO to further improve consumer choice, reliability and efficiency.

Concluding remarks – a USO fit for the future, supporting those most in need

6.57 We welcome Ofcom's CFI on pricing and affordability, it provides a valuable opportunity for all stakeholders to engage with Ofcom on changes that need to be made to the current USO, now and in the future.

6.58 This is an opportunity to further the work started by Ofcom in reforming the USO, thereby reducing the net cost Royal Mail bears as the Universal Service Provider and ensuring a financially sustainable universal service that can evolve to be fit for the future.

6.59 Replacing the current Second Class safeguard cap with a targeted discount scheme would achieve the important dual purpose of enhancing the sustainability of the USO, and crucially, creating an opportunity to provide targeted support to those who need it most in society.

6.60 Further reform of the USO now, in the way envisaged by Ofcom, will avoid for longer the need for more significant reforms, safeguarding a one-price-goes-anywhere USO.

6.61 Nonetheless, the ongoing structural decline of letters and the stark effect of this on the economics of the business cannot be ignored. The future of the USO requires ongoing active stewardship and courageous decision making if it is to remain a vital part of how the UK communicates. To ensure this, we call for a more formalised and regular assessment of the USO between Royal Mail, Ofcom and Government.

6.62 Part of ensuring the USO can thrive is facing into the need for its features to modernise so that it offers products that customers want to buy. Ofcom can start this journey by removing the prohibition of tracking of USO parcels so that we can offer what is now a hygiene factor across all parcel services at a universal price for everyone in the country.

6.63 These changes would remove a blunt regulatory price control whilst providing targeted support to those who need it most in society avoiding the need for more significant reforms to the USO for longer, safeguarding an affordable and sustainable one price goes anywhere service for all.

Classified: RMG – Public

6.64 Further, the regulatory regime could be enhanced through enhancements to the regulatory financial reporting framework and removal of some prescriptive wording in some of the regulatory conditions line with Government's regulatory agenda.

Classified: RMG – Public

Appendix 1 – responses to Ofcom's CFI questions

	Ofcom question	Royal Mail response
2.1	***Do you agree with our proposed objectives for this review? Please state your reasons and provide evidence to support your view.***	We broadly agree with Ofcom's proposed objectives for the review but note that letters operate in a competitive environment hence there is no need for price control mechanisms. Ofcom describes Royal Mail as having a monopoly in letters. However, Ofcom also recognises that the context is very different to other regulated monopolies, with no concerns in post around excessive profits. We explain in Chapter 2 that continued reform of the Universal Postal Service is both essential and inevitable if the USO is to remain financially sustainable, responsive to change, and capable of meeting user needs over the long term. In Chapter 3 we set out how the Second Class safeguard cap can impact the financial sustainability of the USO. In Chapter 6, we set out some specific suggestions for a forward looking strategic approach for ensuring the future of the USO. The universal postal service requires active stewardship – ensuring it remains sustainable for future generations. To deliver this vision, we call for a stewardship framework between Royal Mail, Ofcom and Government to strengthen transparency and shared accountability for the USO's financial sustainability. The regulatory regime could be strengthened through enhancements to the regulatory financial reporting framework and removal of some prescriptive wording in some of the regulatory conditions, in line with the Government's regulatory agenda.

	Ofcom question	Royal Mail response
2.2	***Do you agree with our planned approach to this review? Please state your reasons and provide evidence to support your view.***	We broadly agree with Ofcom's planned approach for the review of pricing and affordability. As set out in Chapters 3 and 5, we consider that introducing price controls would be a retrograde step that could undermine our ability to provide an efficient and financially sustainable USO. We agree that the focus of the review should be on letters but, as set out in Chapter 6, there are some further changes to the DUSP regulations (tracking and Special Delivery) that would enable us to modernise our USO parcel offering to better reflect customer needs. As set out above, we have asked Ofcom to take a longer term view and to go further to secure the financial sustainability of the USO. In particular, as we set out in Chapter 2, ongoing reform of postal regulation is inevitable given the structural decline in letter volumes and growth in addresses that fundamentally change the economics of letter delivery. As we set out in Chapter 6, Royal Mail, Ofcom and Government each have different but important responsibilities in ensuring the future of the USO through collective, proactive stewardship. This will need to be supported by a more strategic monitoring framework as well as changes to the USO that will allow Royal Mail to be more responsive to changing customer needs.
3.1	***Do you agree that our approach to assessing the affordability of universal postal services should be similar to the approach we have taken previously? Please state your reasons and provide evidence to support your view.***	Yes. We have set out in Chapter 3 that we agree the best approach to assess affordability is to understand where people suffer significant detriment as a result of current prices. We agree that the focus of the assessment should be on the affordability of letters due to the highly competitive nature of the UK's parcel market. We also agree that it is right to focus on consumers, in particular those consumers who are more likely to be vulnerable to affordability concerns.

	Ofcom question	Royal Mail response
3.2	***Do you agree with our initial observations from our preliminary analysis of the latest ONS data and market research? Please state your reasons and provide evidence to support your view.***	Yes. We have set out in Chapter 3 why we do not think there is a general affordability issue in post. At c.12p per week, spending on USO letters by households in the lowest income decile accounts for a very small fraction of household spend. As we have set out in Chapter 3 we agree with Ofcom's assessment that that customers on lower incomes, those unable to leave home without help, benefits recipients and those with an impactful illness of condition are more likely to state that they have experienced affordability problems with post. Whilst using the receipt of means-tested benefits as eligibility criteria may be a pragmatic approach, further work is needed to ensure that the scheme is more effectively targeted at customers that actually need support as this could potentially allow for the scheme to offer more support on a per customer basis.
4.1	***Do you have any comments on whether a targeted discount scheme could be used to address affordability concerns in post?***	We agree with Ofcom's initial view that a targeted scheme would help to both protect the sustainability of the USO, and to ensure that it is affordable. We have set out in Chapter 3 why a price cap is a blunt and ineffective tool to achieve Ofcom's policy objectives. In Chapter 4 we set out the principles that might apply to a targeted scheme, building on those set out by Ofcom in its CFI. We also consider the relative advantages and limitations of different potential design elements.
4.2	***Do you have any specific comments or evidence relating to the key elements and principles of a potential scheme set out in this section?***	We set out in Chapter 4 the design principles that we believe should underpin a targeted scheme. Key principles of the scheme must be: • that consumers who are considered to have postal affordability concerns will be meaningfully better off through effective targeting of the scheme at those who need it most; • is easy to access and use; • is self-funding, rather than taxpayer funded; and • supports Ofcom's statutory duty to secure a financially sustainable USO protecting the one-price-goes-anywhere service for all and allowing us to invest in benefits for our customers overall. Furthermore, in its implementation, the scheme should minimise economic distortions and minimise fraud. We need greater clarity on Ofcom's overall approach to price caps before it is possible to provide a fully formed proposal for the scheme, including what the appropriate level of discount should be. The CFI is an important first step and we intend to refine our approach through engagement with different stakeholders as well as Ofcom.

	Ofcom question	Royal Mail response
5.1	***Do you have any comments on our initial views set out in paragraphs 5.2-5.16 in Section 5 on whether there is a case for Ofcom to move away from its existing approach to price regulation of Royal Mail's letter services based on considerations other than affordability?***	We agree with Ofcom's view that the alternative approaches that it discusses in Section 5 of its CFI do not have any clear advantages over its current approach to price regulation. We agree with Ofcom that replacing the Second Class safeguard cap with other price controls would be unnecessary and undesirable. We set out our views in more detail in Chapter 5.
5.2	***Do you have any comments on Ofcom's plans to examine aspects of the margin squeeze rule for access prices?***	In Chapter 5, we set out why we consider Ofcom should consider either removing or making changes to the regulatory margin squeeze control (USPA6). We agree with Ofcom that there is no evidence to support bringing unsorted mail into the test. Ofcom has stated that the upstream market for bulk letters is working well. We disagree with any suggestion that multiple baskets (based on speed) should be introduced. We consider that increasing the number of baskets, as discussed by Ofcom, will only lead to higher prices as we would have to cover fully allocated costs (FAC) on a narrower set of products, and ultimately less choice for customers. We believe there is an opportunity for Ofcom to reconsider the cost metric used in the USPA6 test so it better reflects competitive dynamics by using an incremental cost metric rather than FAC.

Appendix 2 – Pricing ladder differentials

Stamp to Meter Prices

A2.1 Stamps require the customer to purchase a physical stamp and/or print out an online stamp and attach it to the letter in question. A customer choosing to use a meter machine will need to invest in a franking machine which can then be used to apply an indicia to the letter.

A2.2 The stamp versus meter gap has been closed to 3p. We do not wish to close it any further and ideally we would increase the differential. We are being forced to keep the differential this small because we are constrained by the Second Class stamp price. The necessity to have a gap reflects both that it is more efficient and hence cheaper for Royal Mail to handle a letter through the meter channel but there are extra expenses for a meter customer above that of a stamp customer i.e. the cost of the meter (franking) machine. Therefore, there needs to be a price difference to make the meter channel viable for customers.

A2.3 The benefit for customers using meters versus using stamps is generally a lower price. To use this channel, customers must send sufficient volumes to cover the cost of investing in a meter machine. The estimated average cost of renting the meter machine is c£40 per month (range £20–£300), although varies greatly by type of machine, size of organisation and processing speed. However, as the gap between stamp and meter has narrowed, the meter product has started to become unviable for a number of meter users.

A2.4 From Royal Mail's perspective, the meter channel is operationally more efficient:

- Royal Mail pays a commission to POL or other retailers for stamp sales. This is currently [✂]% of the 87p price of a Second Class stamp letter item or [✂]. No such costs are incurred in the meter channel; and
- collection costs are usually lower for meter customers. Meter customers can use POL; bring their postings directly into a Royal Mail site or arrange for a collection (which will need to be paid for if annual postings across all services are under £20,000).

A2.5 Stamps are generally the most inefficient channel due to:

- low volumes and a high level of manual effort to process (including presenting to sorting machines); and
- stamps have the lowest level of automated sortation due to factors such as hand written addresses and envelope colour.

A2.6 To date, we have limited evidence on the impact of closing the gap but the preliminary indications are that we are already starting to see meter volumes fall. Both First Class and Second Class Meter have been in worsening decline since spring/summer 2023.

A2.7 We have also had feedback from the meter manufacturers that they are seeing increasing numbers of customers looking to move to digital.

Meter and Business Mail Unsorted

A2.8 Account customers sending Business Mail Unsorted services tend to be larger than meter customers. On top of that, business mail unsorted customers specifically will be posting a minimum of 250 items a time, have the benefit of attracting volume related discounts (VRDs) and pay VAT so will almost certainly be VAT registered.

A2.9 We have aligned meter and business mail unsorted (non-Mailmark) prices in the current pricing ladder but this is not ideal. Whilst they are similar services – both being manual letters, they aimed at customers with different characteristics. We have only aligned them due to the

constraint of the Second Class stamp price. We believe there should be a small gap in the order of [✂].

A2.10 From a Royal Mail perspective, Meter mail is generally less efficient for us to handle. It is presented in pouches, which require post persons to cut the bags open, tip the mail out of the bags and sort the mail for presentation to sorting machines. Conversely [✂]% of Business Mail Unsorted Manual (USO Account & Business Mail Account) are presented in trays which makes the mail ready for machine presentation. The majority (c. [✂]%) of Business Mail Unsorted Manual is processed by Royal Mail Sorting machines. Trays are placed in Yorks that are wheeled to sorting machines where the trays of mail are tipped onto the sorting machine feeder. This makes Business Mail Unsorted Manual more efficient than meters.

A2.11 Business Mail Unsorted Manual also tends to have addresses printed with black ink that has higher machine read rates than meter mail where addresses are printed in blue ink and higher average posting volumes than meters.

Manual to Machinable Products

A2.12 The key difference here is that manual products require higher levels of manual intervention to process the mail.

A2.13 Business Mail Advanced (BMA) / Mailmark products are better from a customer perspective as they provide more information and at a cheaper price; they are also better for Royal Mail as they are operationally more efficient and easier for revenue protection with a unique identifier.

A2.14 [✂]

A2.15 The band A price of the manual products is now the same as the meter products and we are constrained by the Second Class stamp price above it in the pricing ladder. Therefore, as we increase the price of business mail products to support financial sustainability in a declining market, we are in effect forced to reduce the manual versus machinable gap.

Retail to Access

A2.16 Below the retail products are their access equivalents. These are set and published first in any tariff round. The retail prices are then set at a minimum of the access product plus a measure of the upstream cost to ensure all relevant margin squeeze tests are passed. As we flagged earlier, the access price gaps are key drivers influencing the financial impact, so it is crucial we can set these prices at the appropriate level to give customers choice and drive operational efficiencies.

A2.17 There are two key areas where the pricing ladder needs to be taken into account.

Access Standard to Economy

A2.18 This is arguably the key gap in the ladder. The lowest prices in Royal Mail are Access Economy in trays which show a further discount from Standard. They key difference between the two services is speed. Our Standard service is a D+3 service whilst our Economy is a D+5 service.

A2.19 The price gap between these two services gives customers choice. Customers have the opportunity to choose a slower service at a lower price if it is a better fit for their requirements, whilst enabling Royal Mail to become more efficient through delivering more letters to an address at the same time. This product offer was enabled by our investment in the DTS algorithm. Giving customers greater choice on the products available has an added benefit of encouraging customers to keep using letters as a communication channel.

A2.20 The current gap is 10p. Customer migration to the Economy service has already been significant. When looking to move customers to a new service it is often necessary to offer a large discount to persuade customers to make the move. As the market reaches a natural equilibrium, we

believe this gap could be reduced slightly but we need to be very mindful of customers choosing to switch back to the Standard service if the gap gets too small. If this were to happen it would reduce our ability to be more efficient and undermine our investment in DTS. This is therefore a move that needs to happen over time so we can monitor customer behaviour.

Access Manual to Mailmark

A2.21 As we explained in the section above, there are distinct differences between the way manual and Mailmark items are handled in our network and also in the potential benefits to customers. Like our Retail service, over time we have created a significant gap between Access Manual and Access Mailmark services. Mailmark is more operationally efficient for Royal Mail and ensures automated revenue protection. It is also typically the preferred service for customers due to the data insights it provides customers on their mailings.

A2.22 The Access Manual price is now constrained by the meter price, and we are required to undertake the relevant competition law and regulatory margin squeeze tests on an Access plus upstream cost basis. To ensure financial sustainability in a declining letters market, we need to increase the Access prices to offset the impact of structural volume decline, high fixed costs and inflationary cost pressures. If we can't increase the price at the top of the access pricing ladder, we need to close the gaps within it. As a result, the differential to Mailmark will start to close, as we increase Mailmark prices by more than Manual products. This reduces the incentive for customers to use Mailmark products which are more operationally efficient to process and automated revenue protection which ensures we are paid fairly for the activities we carry out.

Appendix 3 – schemes in other sectors

Figure A3.1: Examples of targeted schemes in other sectors

	In the water sector, every water company in England and Wales has a social tariff which can help to reduce bills for households on a low income. Who is eligible for help and the level of support varies depending on the water company. The Water Sure scheme caps annual bills for households that are in receipt of certain income-related benefits **and** either have someone with a medical condition that requires extra water or have three or more children under the age of 19 living at the property making them eligible for child benefits. Other social tariffs are not dependent on the household being in receipt of benefits but instead take account of equivalised income (i.e. income adjusted to take account of the size of the household) and others take account of financial difficulty. Support offered includes discounts ranging from 15% to 90% depending on the provider and eligibility criteria, capping the maximum bill; and fully waiving the water bill for an eight week period if a claimant has no income whilst waiting for the Universal Credit Application to be processed (South Staffordshire Water).
	The Warm Homes Discount is a one-off annual discount off a household electricity bill. This applied automatically to the bill except in Scotland where customers need to contact their energy supplier to apply. Customers living in England and Wales qualify either because they receive the Guarantee Credit element of Pension Credit, or because they are on a low income (assessed in terms of whether a household is in receipt of means-tested benefits).[145]
	Central and local Government also make direct payments to households to support the affordability of energy. This includes the Winter Fuel Payment, the Cold Weather Payment, fuel vouchers from local councils for prepayment meters and local energy grants. The industry provides further support to help households manage energy debt (e.g. grants offered by energy companies and charitable trusts) and pay for energy saving home improvements.
	In the broadband sector, social tariffs are available from a number of providers. These offer lower cost broadband access for households that are in receipt of income based benefits. For example, Sky offers existing customers a social tariff offering access to its Full Fibre 75 or Full Fibre 100 package for £20pm.[146] This compares to £25pm for the Full Fibre 75 and £38 pm for the Full Fibre 100 packages.[147]
	For mobile phone services, there are a number of different social tariffs. For example, the O2 essential plan offers 10GB of data and unlimited calls and texts for £10pm for people in receipt of income-related benefits. This compares to the currently cheapest available SIM only contract of £16 pm for 3GB of data or £17.99 pm for 10GB (both with unlimited calls and texts).[148]

Figure A3.2: Differences between post and other sectors

Substantially lower household spending	Household spend on energy and water is far higher than spending on post. This means that even proportionately very small changes to bills can have a more material impact on households than even very large changes to the price of postage.[149] This also means that the effective discount offered will be higher in absolute terms, making it more worthwhile for the utilities provider to invest in robust eligibility checking mechanisms to avoid fraudulent applications.
No accumulation of debt	It is not possible to accumulate debt in relation to stamps. Similarly to above, proportionately small changes to utilities bills can have a cumulative impact not just on levels of debt but subsequently also on personal credit ratings. This also increases the incentive for the utility provider to offer a concessionary tariff in order to reduce the risk of a household repeatedly defaulting on bills. [150]
No ongoing relationship with consumers at point of sale	Royal Mail does not have a direct ongoing relationship with consumers at the point of sale. In the energy and water sectors, consumers typically have an account which is billed on a monthly basis (except for prepaid energy meters). This has two effects. First, it makes it easier for utilities providers to identify when a household is in need of extra support (e.g. because the company is able to see when a household defaults on payments). Second, it increases the incentive to offer a concessionary tariff by reducing the risk of a household defaulting on bills.
No special provisions in legislation for data sharing	There are special provisions in legislation that allow utilities providers to access DWP data to determine whether an individual is in receipt of certain benefits payments and therefore eligible for the tariff.
High potential for arbitrage	There is limited scope for arbitrage in utilities, unlike in post where stamps can be easily transferred between individuals or households.

END

Endnotes

[1] Planning overhaul to reach 1.5 million new homes - GOV.UKwww.gov.uk/government/news/planning-overhaul-to-reach-15-million-new-homes
[2] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability.
[3] This is based on Royal Mail v5 data for First and Second Class letters, excluding large letters, adjusted to reflect that c. [✂]% of stamps are used by businesses rather than households.
[4] PostNord has announced that it will stop handling letters in Denmark after the end of this month. PostNord to discontinue handling mail in Denmark in 2026 – focusing exclusively on parcels | PostNord, accessed 1 December 2025
[5] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, table 3.
[6] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 1.4.
[7] HM Treasury, 2025. Regulation Action Plan - Progress Update and Next Steps.
[8] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, pages 4 and 9.
[9] Ofcom, 2024. The future of the universal postal service, paragraph 8.16.
[10] HM Treasury, 2025. Regulation Action Plan - Progress Update and Next Steps.
[11] HM Treasury, 2025. Regulation Action Plan - Progress Update and Next Steps.
[12] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability.
[13] Based on the forecast volumes above and ongoing delivery point growth at the historic level of 250.000 per annum.
[14] Royal Mail analysis.
[15] Ofcom, The future of the universal postal service, 24 January 2024, paragraph A7.65.
[16] Ofcom, The future of the universal postal service, 24 January 2024, paragraph 2.36.
[17] Royal Mail's unapproved 2025 Business Plan projection and supporting scenarios submitted to Ofcom June 2025.
[18] Ofcom, 2025. Review of the universal postal service and other postal regulation, paragraph 4.50.
[19] See PostNord will deliver its final letter at the end of 2025 | PostNord, accessed 10 October 2025
[20] See PostNord to discontinue handling mail in Denmark in 2026 – focusing exclusively on parcels | PostNord, accessed 10 October 2025.
[21] Cullen International, 2025. USO funding: payment of compensation. Based on Cullen's analysis of European postal markets, the following 11 countries currently provide compensation funding for the net cost of their universal postal service: Croatia, Czech Republic, Denmark, Estonia, France, Italy, Latvia, Lithuania, Netherlands, Poland and Spain.
[22] Against a backdrop of declining mail volumes and increasing financial losses by La Poste, in 2021 the French Government authorized state aid during the period 2021–2025 with annual payments in the range of €500 - €520 million. These payments were required to support the continued delivery of the USO and to support strategic transformation from a letter-centric model to a parcel-focused business.
[23] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 1.1
[24] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 1.4.
[25] BMG Research, 2025. Post User Needs Research 2024, page 8.
[26] Ofcom, 2025 Review of the universal postal service and other postal regulation, paragraph 2.23.
[27] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 3.8.
[28] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 3.11.
[29] Oxera, 2022. UK consumer parcels: Assessment of tracking in the Universal Service.
[30] Ofcom, 2024. Post monitoring report 2023-24, page 6.
[31] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 3.41.
[32] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 3.46.
[33] ONS 2025. Family spending in the UK: April 2023 to March 2024.
[34] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, figure 1.
[35] Royal Mail analysis of revenue data shows that c.£ [✂]m revenue was generated from stamped letters in 2024/25, with c. [✂] of this spent by consumers (based on Mail Characteristic Survey, MCS). Divided amongst 28.6m households (ONS), this gives on average £12.50 spent by consumers on stamped letters per household per year.
[36] This takes the ONS data on spending on post by households in the lowest income (which includes all post i.e. all types of letters and parcels, as well as spend on products and services from other providers) and multiplies it by a factor to estimate the spend on First and Second Class letters (but excluding Large Letters). This factor is based on Royal Mail v5 data for 2024/25 on total revenue from First Class and Second Class letters from both stamps and online sales of postage. This includes revenue from our own retail channels as well as from Post

Office. It does not include revenue from Large Letters This revenue figure is then divided by the UK average adult population to arrive at an average spend per customer on letters. This is then used to estimate the proportion of total spend on post that is First and Second Class letters.

[37] Jigsaw 2025. Post affordability: benefits recipients' perspective on a potential targeted discount scheme, page 8.

[38] Royal Mail analysis is undertaken on the 27 European Union (EU) member states and the two European Free Trade Association (EFTA) countries of Norway and Switzerland, where prices can be clearly and publicly identified. Prices are correct at 4 November 2025.

[39] Prices adjusted for Purchasing Power Parity (PPP).

[40] Ofcom allowed a 5% increase in the Second Class safeguard cap in 2019.

[41] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 2.31.

[42] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 1.4.

[43] Ofcom, 2025. Telecommunications Market Data Update, page 1.

[44] In table 6 of its CFI, Ofcom has proposed that disposable income for consumers in the bottom decile of earners (equivalised) is £893.75 per month. According to the ONS Family Spending in the UK report, the average weekly expenditure of this same group is £358.60 per week or £1553.93 per month.

[45] ONS Detailed household expenditure by equivalised disposable income decile group (OECD-modified scale).

[46] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 3.40.

[47] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 3.39.

[48] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 3.43.

[49] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 3.47.

[50] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 3.40.

[51] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 5.13.

[52] The Reported Business is the regulatory entity which contains the Universal Postal Service network and all the products provided through, or in relation to that network.

[53] Royal Mail, Regulatory Financial Statements 2024/25. The £15m loss is using Ofcom's Financeability EBIT measure which is operating profit after transformation costs (which included Voluntary Redundancy (VR)). Excluding VR costs of £20m, the Reported Business made an operating profit of £5m in 2024/25.

[54] Richard Hooper, 2010. Saving the Royal Mail's universal postal service in the digital age, page 27.

[55] Royal Mail, 2023. Response to Ofcom's consultation - Review of Second Class safeguard caps 2024

[56] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 4.3

[57] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, table 8.

[58] The Green Book and accompanying guidance - GOV.UK, The Green Book and accompanying guidance, published 16 November 2020, last updated 15 October 2025. Green Book sets out HM Treasury guidance on how to appraise policies, projects and programmes and "*supports proper consideration of the costs, benefits, and trade-offs of alternative options for delivering policy objectives*."

[59] This builds on a literature review e.g. Policy in Practice, 2024. Missing out 2024: £23 billion of support is unclaimed each year ;
Citizens Advice, 2025. Barriers to access; Why water and broadband social tariffs aren't reaching struggling households; and Ofcom, 2024. Why don't more low income consumers buy high quality, lower cost broadband?

[61] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 4.17

[62] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 3.11

[63] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, e.g. paragraph 4.14 and paragraphs 4.60-4.63

[64] See, for example, Policy in Practice, 2024. Missing out 2024: £23 billion of support is unclaimed each year

[65] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 4.18/ Table 8.

[66] WIK, 2025. Future of post: Exploration of potential discount schemes for universal services, page VI.

[67] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 4.6.

[68] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 4.20.

[69] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 3.13 and also Ofcom 2023 safeguard cap decision statement.

[70] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 3.43.

[71] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 3.40 and 4.20

[72] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 3.58.

[73] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 4.24.

[74] These benefits are Child Tax Credit, Housing Benefit, Income Support, Income-based Jobseeker's Allowance (JSA), Income-related Employment and Support Allowance (ESA) and Working Tax Credit. Concessionary discount for Redirections | Royal Mail Group Ltd, accessed 1 December 2025

[75] DWP intends to complete the roll out of Universal Credit by March 2026. Source: 220,000 vulnerable customers given personalised support to move to Universal Credit - GOV.UK, DWP press release published 14 November 2025 (accessed 4 December 2025). Until that time, we would also accept applications from consumers in receipt of the following legacy benefits: Child Tax Credit, Housing Benefit, Income Support, Income-based Jobseeker's Allowance (JSA), Income-related Employment and Support Allowance (ESA) and Working Tax Credit.

[76] ONS, September 2025. Estimates of the population for the UK, England, Wales, Scotland, and Northern Ireland Mid-2024 dataset. The total UK adult population is given as 55m.

[77] Based on DWP benefits statistics: August 2025 and adjusted for an estimate of overlap based on DWP Benefit Combinations: Official Statistics to February 2025. This estimate includes legacy benefits including income-related Employment and Support Allowance (ESA) and income-based Jobseeker's Allowance (JSA).

[78] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 4.22.

[79] In Ireland, An Post offers a voluntary scheme allowing residents of nursing and care homes to send national letters free of charge, and also for their family and friends to freepost to such homes. Source: WIK, 2025. Future of post: Exploration of potential discount schemes for universal services, page 8 and page 49.

[80] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 4.8.

[81] WIK, 2025. Future of post: Exploration of potential discount schemes for universal services, table 3.

[82] Stamp prices - Australia Post, accessed 4 December 2025.

[83] https://auspost.com.au/shop/collectables/stamp-issues/australian-stamps/christmas-2025, accessed 4 December 2025.

[84] Send Christmas cheer | Posti and Posti letter and postcard pricing | Posti, both accessed 4 December 2025.

[85] The red mailing envelopes for Christmas greetings to be delivered to homes at the end of November, accessed 4 December 2025.

[86] Alles over het gebruik van decemberzegels | PostNL

[87] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 4.34.

[88] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 3.42.

Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 4.37.

Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 3.16, 3.18.

Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 4.39.

[92] Ofcom, 2025 Review of the universal postal service and other postal regulation, paragraph 4.45.

[93] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, e.g. Table 8.

[94] Ofcom, 2024. Why don't more low income consumers buy high quality, lower cost broadband? published 19 April 2024.

[95] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 4.25-4.26.

Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 4.28.

[97] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 4.27: "e.g. posters and leaflets in post offices, libraries, council offices and community centres, DWP/job centres to communicate a scheme alongside benefits, direct mail/flyers delivered by Royal Mail, wider advertising such as social media, working with other organisations such as charities or local authorities who are likely to be already engaging with households in need of help."

[98] Online journals are a platform through which recipients receive and provide information in relation to their benefits (e.g. requests for identification checks and health information to demonstrate eligibility for certain benefits).

[99] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 4.30.

[100] DWP, 2025. DWP benefits statistics: August 2025; updated 1 October 2025; accessed 1 December 2025. 7,515,100 claiming UC plus 1,395,900 claiming PC as at February 2025. This does not include legacy benefits such as Employment Support Allowance.

[101] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 4.31.

[102] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 4.32.

[103] Jigsaw, 2025. Post affordability: benefits recipients' perspective on a potential targeted discount scheme, page 9.

[104] Jigsaw, 2025. Post affordability: benefits recipients' perspective on a potential targeted discount scheme, page 31.

[105] Get a proof of benefit letter - GOV.UK, accessed 4 December 2025.

[106] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 4.32.

[107] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 4.33.
[108] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 4.32.
[109] Policy in Practice, 2024. Missing out 2024: £23 billion of support is unclaimed each year, page 8. One example is its work with local agencies to promote take up of Healthy Start which provides pregnant people and families with young children with help to buy healthy food and milk.
[110] Policy in Practice, 2024. Missing out 2024: £23 billion of support is unclaimed each year, page 5.
[111] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 4.47.
[112] Ofcom, 2025. Call for input: Review of postal regulation – pricing and affordability, paragraph 4.47.
[113] Policy in Practice, 2024. Missing out 2024: £23 billion of support is unclaimed each year, page 28.
[114] Source: Citizens Advice, 8 March 2023 "Fairer, warmer, cheaper: new energy bill support policies to support British households in an age of high prices"
[115] Policy in Practice, 2024. Missing out 2024: £23 billion of support is unclaimed each year, page 10. Citizens Advice calls for "*automation by design*" (i.e. using DWP data to automate eligibility assessments and awards) in the water sector. Source: Citizens Advice, 2025. Barriers to access; Why water and broadband social tariffs aren't reaching struggling households.
[116] Ofcom 2012. Securing the Universal Service, paragraph 2.4.
[117] Ofcom 2012. Securing the Universal Service, paragraph 2.5.
[118] Ofcom 2012. Securing the Universal Service, paragraph 7.45.
[119] Royal Mail plc, Annual Report and Financial Statements, Royal Mail's adjusted operating profit after transformation costs 2014-15.
[120] Ofcom, 2025. Review of the universal postal service and other postal regulation, paragraph 7.159-7.160.
[121] Ofcom, 2025. Review of the universal postal service and other postal regulation, paragraph 7.160.
[122] Ofcom, 2025. Review of the universal postal service and other postal regulation, paragraph 4.20.
[123] Ofcom, 2025. Review of the universal postal service and other postal regulation, paragraph 1.37.
[124] For context USO reform took nearly two years from Ofcom's announcement in September 2023 to its decision document in July 2025.
[125] Cullen International 2025.
[126] Cullen International, 2025.
[127] https://www.postbranche.de/2019/10/02/dvpt-statement-zur-pressekonferenz-der-dpag-und-deren-plaene-zur-digitalen-transformation/
[128] https://group.dhl.com/content/dam/deutschepostdhl/en/media-relations/press-releases/2024/pr-new-postal-law-20240705.pdf
[129] Ofcom, 2025. Review of the universal postal service and other postal regulation, paragraph 4.17.
[130] Ofcom, 2025. Review of the universal postal service and other postal regulation, paragraph 4.18.
[131] Ofcom, 2025. Review of the universal postal service and other postal regulation, paragraph 4.17.
[132] Ofcom, 2025. Review of the universal postal service and other postal regulation, paragraph 4.18.
[133] New approach to ensure regulators and regulation support growth (HTML) - GOV.UK
[134] HM Treasury, 2025. New approach to ensure regulators and regulation support growth, policy paper, action 2.
[135] Ofcom, 2025. Review of the universal postal service and other postal regulation, paragraph 4.20.
[136] Ofcom, 2022. Review of Postal Regulation, paragraph 3.43.
[137] Ofcom, 2022. Review of Postal regulation, paragraph 3.60(b).
[138] These could include FFO/net debt or debt covenant cover metrics which are important to the short-term viability.
[139] Ofcom, 2024. The future of the universal postal service, paragraph 8.16.
[140] Ofcom 2022 Review of Postal Regulation: Statement, paragraph 2.82.
[141] Ofcom: Measuring user experience of parcel delivery to residential addresses 22 October 2025, slide 21.
[142] DUSP 1.6.1(a) and DUSP 1.6.1(b).
[143] DUSP 1.6.1(d).
[144] PSA 2011: Requirement 4 (registered item service) and Requirement 5 (insured item service).
[145] Warm Home Discount Scheme: Overview - GOV.UK, 9 October 2025. Eligible benefits are Housing Benefit, income-related Employment and Support Allowance (ESA), income-based Jobseeker's Allowance (JSA), Income Support, the 'Savings Credit' part of Pension Credit and Universal Credit.
[146] Sky social tariffs | Sky Help | Sky.com | Sky Help | Sky.com, accessed 4 December 2025.
[147] Source: Sky website accessed 4 December 2025.
[148] SIM Only Deals | Compare our Best SIM Only Contracts, accessed 4 December 2025.
[149] For example, IPPR found that "*Social tariffs across [energy, water, broadband and car insurance] markets could make a significant difference: a 25% discount on these four bills would save the average low income*

household £13 a week, or £680 per year. This would be equivalent to a boost of disposable income by around a tenth for a typical household in this group." IPPR also found that "*The poorest 10% of households will be spending two fifths (41%) of their disposable income (after housing costs) on core bills [water, energy, broadband and car insurance] at the median, compared to 5% amongst the richest households*." Source: IPPR, Essential Potential. An analytical briefing prepared by the Institute for Public Policy Research as part of a partnership with Citizens Advice and abrdn Financial Fairness Trust, March 2025.

[150] "*Last year Citizens Advice helped more than 90,000 people with energy debts*," "*In 2024, 51% of Citizens Advice debt clients had an energy debt and 38% had water arrears*" Source: IPPR, Essential Potential. An analytical briefing prepared by the Institute for Public Policy Research as part of a partnership with Citizens Advice and abrdn Financial Fairness Trust, March 2025.