

Review of the Postal Tariff Mechanism:

Safeguarding the Sustainability of the Universal Postal Service

Consultation and Proposed Decision

MCA Reference: MCA/C/24-5356

Publication Date: 12th July 2024

 (+356) 2133 6840  info@mca.org.mt  www.mca.org.mt/


 Valletta Waterfront, Pinto Wharf, Floriana FRN1913, Malta

TABLE OF CONTENTS

1	Summary	1
2	Tariff Revision Mechanism	2
2.1	Current Process	2
2.2	Proposed Mechanism	2
2.2.1	Context of Universal Service Financial Performance	2
2.2.2	Design and Procedure of the Proposed Mechanism	2
3	MCA's Evaluation and Proposed Decision	4
4	Consultation Framework	5
	Annex 1	6

1 Summary

As part of the Universal Postal Service (hereafter the 'Universal Service'), MaltaPost plc (hereafter 'MaltaPost') provides customers with various services nationwide in accordance with Maltese Law.

During Financial Year (hereafter 'FY') 2022, MaltaPost faced several challenges in terms of market developments, including the continuation of market trends aggravated by COVID-19, BREXIT, the introduction of VAT for low-value items from non-EU countries, and other global market forces. Apart from postal market dynamics, costs kept increasing both locally and internationally. The aggregate effect of these elements negatively impacted the financial performance of the universal postal service, which incurred a loss of € 0.5 million in FY 2022. During FY2023, although MaltaPost managed to mitigate its costs, the financial performance for the universal postal service fared only slightly better than break-even; hence sustainability remains very volatile in view of market developments.

Apart from taking measures to contain further its costs, in order to improve the sustainability of the Universal Service MaltaPost also submitted various proposals to review specific postal service characteristics and tariffs. These proposals were analysed by the Authority, and following public consultation a decision¹ was published on 21st August 2023.

In the meantime, amendments to the Postal Services Act (Cap 254) are also envisaged in order to enhance flexibility in defining universal postal services². Apart from reviewing postal services characteristics to enable MaltaPost to manage its costs in the provision of the Universal Service, a comprehensive strategy to support sustainability also requires MaltaPost to be able to revise its tariffs in a manner that addresses the ongoing market dynamics and challenges by taking into account volume and cost developments, whilst respecting the tariff principles enshrined in legislation. Hence, a mechanism was developed that automatically caps price increases, following various discussions between the Malta Communications Authority (hereafter 'MCA'), MaltaPost and Government.

The MCA is publishing the proposed tariff revision mechanism, enabling stakeholders to provide feedback as required by article 4A of the Malta Communications Authority Act [Chapter 418 of the Laws of Malta] while considering the financial and market challenges impacting universal postal services.

Section 2 of this document describes the proposed mechanism. Section 3 provides an overview of the main points evaluated by the MCA. Feedback may be sent to the MCA as laid out in Section 4.

¹<https://www.mca.org.mt/sites/default/files/Providing%20Sustainable%20Universal%20Postal%20Services%20Decision.pdf>

² <https://www.gov.mt/mt/publicconsultation/Pages/2023/L-0020-2023.aspx>

2 Tariff Revision Mechanism

2.1 Current Process

The current process for requests by MaltaPost to change tariffs for services which are part of the universal postal service is based on case-by case applications. Any changes in the tariffs of regulated postal services thus require several steps before they are approved. Hence, the current procedure is time-consuming and restricts the opportunity to take proactive measures in step with dynamic market developments.

2.2 Proposed Mechanism

Discussions between MaltaPost, the MCA, and Government were held to address the shortcomings of the current process. The proposed tariff control procedure is based on the development of a mechanism that takes into account financial performance and market developments to safeguard the sustainability of the universal postal service.

2.2.1 Context of Universal Service Financial Performance

During FY2022, the universal postal service reported a loss of approximately €500,000. Postal volumes continued decreasing following the impact of Covid-19, Brexit, the introduction of VAT for low-value items from non-EU countries, and further digitalisation of correspondence. At the same time, pressures acting on costs kept increasing locally, such as Cost of Living Allowance (hereafter 'COLA') and inflation, and internationally, such as terminal dues and transport costs.

During FY2023, although further market challenges were present, MaltaPost managed to mitigate the financial challenges. This resulted in a performance that was slightly better than break-even for the universal postal service. Although the universal postal service did not remain loss-making, it is clear that its sustainability remains volatile and subject to developments in market trends and costs both locally and internationally.

2.2.2 Design and Procedure of the Proposed Mechanism

The ongoing provision of the universal postal service depends on it being financially sustainable in the face of the above-mentioned challenges. Therefore, the mechanism was designed to determine a tariff capping for those postal services provided by MaltaPost that fall within the scope of the Universal Service, and are subject to specific criteria as defined in the new mechanism.

The new mechanism follows a process that includes various steps and controls to ensure proper data mapping (further details are given in Annex 1).

Below is an overview of the process:

- The focus of the mechanism is to review the tariffs of those services that:
 - o Fall within the scope of the Universal Postal Service;
 - o Are subject to price regulation;
 - o Their profitability is lower than a determined return on sales.
- The mechanism is based on the Audited Regulatory Accounts of the previous Financial Year³.
- Apart from the Audited Regulatory Accounts, the mechanism requires further cost-related inputs that MaltaPost needs to populate. The main cost drivers are wages and salaries, terminal dues, conveyance costs, and the inflation rate. These cost aspects are mapped accordingly to the various universal service products and cost elements.
- Based on the inputs and trend analysis, the mechanism estimates the volumes and costs for the following financial year.
- Given the above-mentioned criteria, the mechanism will assess the tariff caps for the various identified services in order to obtain the determined return on sales.
- The mechanism foresees that the tariff caps would be revised every three years³; however, should there be unforeseen extraordinary circumstances occurring during the three-year cycle, the mechanism incorporates two additional triggers: one related to costs and the other related to volumes, which could enable tariffs to be revised during the three-year cycle.
- Once the model is populated and run by MaltaPost, it is submitted to the MCA before the implementation of new rates.

³ The initial run based on FY 2023 audited accounts being adopted in generating the first caps with effect from the coming into force of the mechanism.

3 MCA's Evaluation and Proposed Decision

The MCA considers that the financial sustainability of the Universal Service and its future viability is of primary importance.

The proposed mechanism has the objective of supporting continued provision of universal postal services in an efficient manner based on cost orientation. In doing so, the proposed mechanism takes into account relevant parameters and considerations that impact on service profitability of universal postal services. Hence, the proposed mechanism establishes price caps in line with the principle of cost orientation, below which it provides flexibility to the universal service provider to vary its tariffs in response to challenging market conditions and doing away with the process of seeking case-by-case approvals from the MCA.

Given the recent and ongoing challenging market developments impacting on the postal sector, the proposed mechanism will result in prices being more reflective of increases in costs. Hence the MCA also considered service affordability, and in terms of expenditure on postal services notes that the vast majority of households spend less than €20 every year on postal services.

Under the new process MaltaPost shall continue to ensure that the tariffs of the universal postal services, and changes thereto, are published in a transparent and appropriate manner.

Apart from the above, the MCA also intends to continue working in collaboration with MaltaPost and Government to review the commercial sustainability of Universal Service through other possible measures.

Proposed Decision

The postal tariff mechanism summarised in Annex 1 shall come into effect from 1st September 2024.

4 Consultation Framework

In accordance with article 4A of the Malta Communications Authority Act [Chapter 418 of the Laws of Malta], the MCA welcomes written representations from interested parties and stakeholders during the national consultation period from 12th July 2024.

The MCA appreciates that respondents may provide confidential information in their feedback to this consultation document. This information will be included in a separate annexe and marked as confidential. Respondents are also requested to state why the information should be treated as confidential.

For the sake of openness and transparency, the MCA publishes a list of all respondents to this consultation. The MCA will take the necessary steps to protect the confidentiality of all such material as soon as it is received at the MCA offices in accordance with the MCA's confidentiality guidelines and procedures. Respondents are, however, encouraged to avoid confidential markings wherever possible.

All respondents should be submitted to the MCA in writing by no later than 12.00hrs on **9th August 2024**, and addressed to:

Chief of Operations

Malta Communications Authority

Valletta Waterfront, Pinto Wharf Floriana, FRN 1913 Malta

Email: coo@mca.org.mt

Annex 1

Universal Postal Service Automated Price Adjustment Mechanism

Price Mechanism Concept



Automated Price Adjustment Mechanism is based on audited USO financial statements (Accounting Separation).



The estimated Postal Volumes per USO product or service inputted in the Automated Price Adjustment Mechanism will be based on historical volume trends.



Revised tariffs are issued per USO product/service when the Automated Price Adjustment Mechanism is triggered or unless triggered once every three years. Revised tariffs are effective from January of the respective calendar year.



A review of tariffs is triggered before the third year if the variance in cost parameters exceeds the averages of the last two years or if the average variance of the volumes over the last three years surpasses the forecasted volumes.



EBIT ROS serves as a control mechanism for the automated price adjustments.



The revised tariffs will establish a price cap per USO product/service effective from January of the same year (when triggered) or in January of the third calendar year.



The Automated Price Adjustment Mechanism process will be initiated by MaltaPost plc annually not later than the first week of December.



The Automated Price Adjustment Mechanism Calculation, Regulated accounts and supporting documentation will be checked by MCA before the implementation of the APAM process.

Main Cost Drivers & Indicators

The Automated Price Adjustment Mechanism distinguishes between three main USO Service Groupings:



The main cost drivers incurred by MaltaPost plc to deliver the USO services are listed below and a forecast made on each cost driver based on the Selected Indicators:

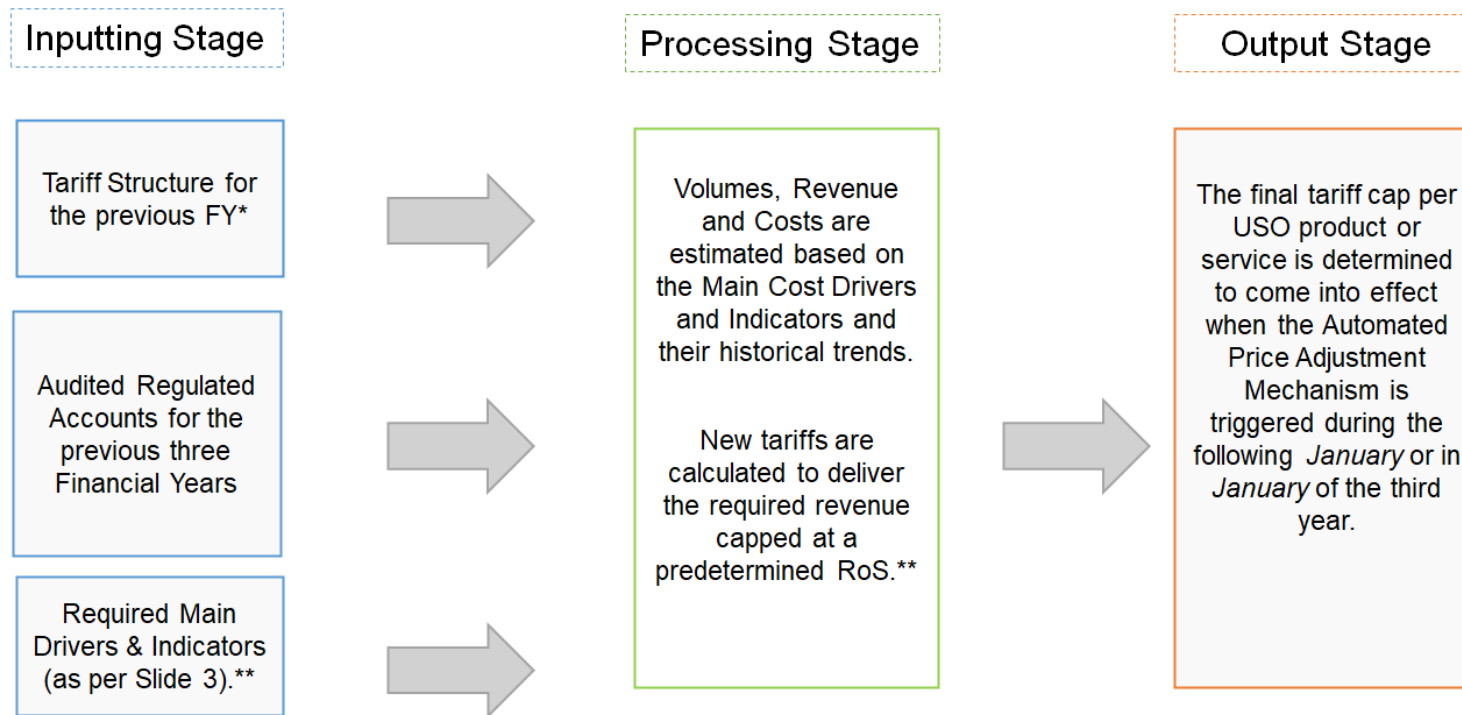
1 **Wages and Salaries**
COLA &
Collective Agreement

3 **Conveyance Costs**
Contracts & Related
Invoices

2 **Terminal Dues**
Regulated Rates published
by the Universal Postal Union

4 **Other Operating and
Non- Operating costs**
Inflation Rate published by
NSO

Automated Price Adjustment Mechanism Process



* If there is more than one tariff change during the same FY in any USO product or service, then the average weighted tariff rate for that product or service is taken into consideration.

** The Automated Price Adjustment Mechanism uses a **Confidential** RoS as a working baseline (Reference MCA – OPS/rt/12-0958).

Main Model Conditions

The model will establish the new tariffs required to achieve the Pre-determined Return On Sales.

The tariffs for the USO products or services will be increased to reach the pre-determined RoS based on the following conditions:

- The product or service is categorised as a Universal Service Obligation.
- The product or service is price regulated by MCA;
- The product or service has a margin lower than the Predetermined RoS*;

If one of the above conditions is not met then USO product or service is excluded from the tariff adjustment process.

** The Automated Price Adjustment Mechanism uses a **Confidential** RoS as a working baseline. (Reference MCA – OPS/rt/12-0958).*

Triggers



The tariffs of any USO service or product will be adjusted when the Automated Price Adjustment Mechanism is triggered or every three years .



The triggers for the USO service or Product come into force in cases when:

1. **Cost** Parameters Variance is greater than the average of the last two years;
2. the percentage variance between the forecasted **volumes** (as per the Automated Price Adjustment Mechanism) and the average variance of the volumes over the last three FY years is greater.

Note: *The cost parameters are annually weighted in line with the operational expenses attributed in the last full FY Regulated Accounts.*

Cost Parameter Variance: A Trigger Example

- % change in Main Drivers & Indicators**
weighted by operational expenses related to:
- Inflation
 - Wages & Cola
 - Conveyance Costs
 - Terminal Dues



% share of Operational Cost			
Type of Cost	FY21	FY22	FY23
Inflation Rate	Confidential		
Wages & COLA			
Conveyance Cost			
Terminal Dues Cost			
Total Operational Cost			

Parameters			
Type of Cost	FY22	FY23	FY24
Inflation Rate	Confidential		
Wages & COLA			
Conveyance Cost			
Terminal Dues Cost			
Total			

Operational Weighting			
Type of Cost	FY22 <small>(based on FY21)</small>	FY23 <small>(based on FY22)</small>	FY24 <small>(based on FY23)</small>
Inflation Rate	Confidential		
Wages & COLA			
Conveyance Cost			
Terminal Dues Cost			
Total			

Average % increase in Cost between FY22 & FY23 Confidential

The Cost Parameter Variance is triggered when the percentage change is greater than the average of the last two years.

The Cost Parameter Variance for FY24 is Confidential which is higher than the average % increase in cost between FY 22 and FY 23 Confidential

This result triggers the Automated Price Revision Mechanism.

Volume Dependant Trigger: An Example

	Reg. Acc. Total Volumes (exc. One offs)	YoY % Diff.	Average of YoY % Diff.	Estimated Price Mechanism Volume	Difference between Estimated Volumes FY24 and Reg. Acc. FY23 (exc. One-offs)
FY21	Confidential				
FY22			Confidential		
FY23					
FY24				Confidential	Confidential

The Volume Parameter Variance is triggered when the percentage variance between the forecasted volumes (as per the Automated Price Adjustment Mechanism) and the average variance of the volumes over the last three FY years is greater.

The Volume Parameter Variance (average variance of the volumes over the last three FY years) is Confidential which is more than the difference between the Estimated Volumes FY 24 and the Regulated Accounts Volumes for FY 2023 which Confidential

This result does not trigger the Automated Price Revision Mechanism.

Note: Confidential



MALTA COMMUNICATIONS AUTHORITY

 (+356) 2133 6840
 info@mca.org.mt
 www.mca.org.mt
 Valletta Waterfront, Pinto Wharf,
Floriana FRN1913, Malta