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**ANNEXURE A**

**REVIEW OF TARIFFS FOR CONTENT DISTRIBUTION IN SOUTH AFRICA**

***CLOSE-OUT PRESENTATION FEBRUARY 2017***

**Research Solutions**

Date

## Review of tariffs

1. **Penalty costs**
2. **Categorization of ISPs**
3. **Online licensing: tariffs and penalties**
4. **IARC (economic viability)**
5. **Roundtable discussions with stakeholders**
* **Market Analysis Report**
* **International Benchmarking Report**
* **Legal Report**
* **Market Trajectory Report**
1. **Fees are generally considered low**
2. **Support is required for smaller players and new entrants**
3. **Local production levels are increasing**
4. **Need to consider external solutions due to media convergence (eg IARC)**
5. **Online distribution of content expected to grow**
6. **International markets differ significantly – difficult to draw directly for tariff structures**
7. **FPB internal processes should be streamlined**
8. **FPB mandate should be well publicised**

|  |  |
| --- | --- |
| **Financial assumption** | **Assumption** |
| 1. Next year CPI | 5.8% |
| 2. CPI thereafter | Based on bond yield curves |
| 3. Investment return | 9.0% |
| 4. Rate of next tariff increase (1 July 2017) | 9.0% |

* 1. Based on variety of projection sources (eg SARB and economists)
	2. Bond yields imply inflation at future terms (average annual to 2021/22 – 6.4%)
	3. To produce return in line with FPB financial team expectation
	4. Catch-up for CPI since previous increase
1. Used 2015/16 revenue & demand for services as base
2. Applied demand trends based on recent experience (considered past 3 years)
3. Considered per revenue category and content types

Eg 2015/16 classification revenue sources:

Game, R18,268

Trailer, R7,994 Erotica, R153,561

Exempted, R309,651

Publication, R56,519

General, R2,190,727

Operational grant incorporated until 2019/20

in line with Treasury communication

## Growth in registrations (10% per year)

1. **Increase in local production (20% per year)**
2. **Continued increase in classification of public format foreign production (14% per year)**
3. **Growth in exemptions for festivals (10% per year) – in line with research findings**
4. **Reduction (20% per year) in classification of: publications, games, erotica, home (Bollywood)**

Distributors considered to pay fees:

|  |  |  |
| --- | --- | --- |
| **Online distributor** | **Category** | **Number of titles** |
| **Films** | **Series** | **Total** |
| OnTapTV | Films/series | 376 | 50 | 426 |
| Netflix ZA | Films/series | 472 | 200 | 672 |
| Multichoice (Showmax) | Films/series | 800 | 400 | 1,200 |
| Multichoice (BoxOffice) | Films/series | 115 | 58 | 173 |
| Google Play ZA | Comprehensive | 1,095 | 270 | 1,565 |
| iTunes ZA | Comprehensive | 2,413 | 1,034 | 3,447 |

* + Grey – film/series split estimated based on other distributors
	+ 2 additional distributors added over next 2 years with 200 titles each, eg. MTN Front Row (VU) & Ericsson (Nuvu)
	+ Content levels expected to grow by 10% per year

R4,000,000

R3,500,000

R3,000,000

R2,500,000

**Annual revenue**

R2,000,000

R1,500,000

R1,000,000

R500,000

R0

Classification Registration Annual renewal Internet SP registration Online licensing Copies of decision

* + - Generally very similar

**Revenue stream**

2015/16 2016/17 (Enterprises) 2016/17 (FPB budget)

* + - Registration more than budget - in line with large increases over last few years
		- Increased demand expected to cause 7.5% increase in revenue per year – comes at cost due to expenses
* Allocated expenses to fixed/variable and direct/indirect
* FPB confirmed fixed/variable split
* FPB provided expenses directly attributable to revenue streams
* 2016/17 expenses set in line with budget

## Increases beyond 2016/17:

* Fixed expenses – generally increase by CPI (exceptions incorporated in analysing 2017/18 budget)
* Direct variable expenses – increase by CPI + change in demand for services of revenue stream
* Indirect variable expenses – increase by CPI + overall change in demand for FPB services

## Online Content Regulation (OCR) System:

* Included upfront capital outlay of R3.8 mil spread over 2 years
* Monthly maintenance costs of R220,980 assumed to continue on ongoing basis
* Costs allocated as direct expense to Online Licensing

## Share of Classifier Cost:

* Classifiers support online with: training (take-on & additional) & classification of sample titles
* Assumed that 22% of classifier time/cost belongs to online due to:
	+ 7.6% of time for training – based on review of classifier payments Dec 2015 – Jul 2016
	+ 15.3% of classification time for sample online titles – based on Showmax experience Jan – Jul 2016

|  |  |  |
| --- | --- | --- |
| **Direct/indirect** | **Fixed/variable** | **ϮϬϭϲ/ϭϳ eǆpeŶse ;R͛ϬϬϬͿ** |
| Direct | Fixed | 7,479 |
| Variable | 19,595 |
| Indirect | Fixed | 62,500 |
| Variable | 7,074 |
| **Total** | **96,648** |

* Indirect fixed costs make up the majority of expenses (65%)
* Total direct costs (R27.1 mil) significantly exceed fee revenue (R7.9 mil)
* This causes a risk of increased demand for services – these run at a marginal loss

70.0%

60.0%

60.0%

**Revenue as % of direct cost**

50.0%

50.0%

40.0%

**Proportion of fee revenue**

40.0%

30.0%

30.0%

20.0%

20.0%

10.0%

10.0%

0.0%

Online licensing Classification Registration Annual renewal ISP registration Copies of certificates

0.0%

Revenue as % of direct cost Proportion of revenue

* + All revenue streams operate at a loss vs direct cost
	+ Operational grant is funding this loss together with additional supporting expenses
	+ Of large revenue streams Classification is most loss-making

# STATUS QUO FINANCIAL PROJECTIONS

***INFLATIONARY INCREASES IN GRANT AND TARIFFS GOING FORWARD***

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **FiŶaŶĐial iteŵ ;R͛ϬϬϬͿ** | **2016/17** | **2017/18** | **2018/19** | **2019/20** | **2020/21** |
| Operational grant | 86,472 | 91,684 | 97,002 | 102,434 | 109,391 |
| Fee income | 7,856 | 9,255 | 10,842 | 11,781 | 12,904 |
| Total revenue | 94,329 | 100,939 | 107,844 | 114,215 | 122,295 |
| Direct costs | (27,073) | (28,700) | (28,751) | (31,084) | (33,884) |
| Variable costs | (7,074) | (7,544) | (8,117) | (8,812) | (9,660) |
| Fixed costs | (62,500) | (67,279) | (70,272) | (75,106) | (79,682) |
| Total expenses | (96,648) | (103,524) | (107,139) | (115,002) | (123,226) |
| **Result before investments** | **(2,320)** | **(2,584)** | **705** | **(787)** | **(930)** |
| Investment income | 724 | 569 | 535 | 580 | 555 |
| **Final result** | **(1,596)** | **(2,016)** | **1,240** | **(207)** | **(376)** |
| Investment reserves | 7,610 | 5,594 | 6,834 | 6,627 | 6,251 |

* Initial losses due to OCR system
* Fast growth in fee income due to – new online distributors, growth in registration, classification of local production, festivals
* Financial pressure due to: OCR cost, growth in demand (direct cost), risk of operational grant not increasing at CPI

## Ensure FPB remains financially sustainable

Reserves at least 10% of cost in 2020/21 and not less than 5% in the interim

Approx R8.3 mil additional revenue needed over next 5 years

## Pressure on operational grant

Increase of 2% below CPI for 2020/21

## Fees should be fair

Relative to ability to pay and value (cost) of service obtained

## Tariff regime should provide support for smaller/informal market participants

Reduced fees to avoid barriers to market entry

## Practical/legislative impacts should be minimised

Eg new tariffs set bearing in mind existing tariff structure –minimises admin/system changes

## FPB should be able to realistically fulfil its mandate

Eg unrealistic to expect that FPB can oversee level of online content

## Revenue should be maximised where possible

Not to produce surplus but to minimise fees elsewhere

## Penalties should deter non-compliance

Penalty cost in excess of compliance cost to encourage compliance

**Membership of IARC is recommended (pilot initially) due to:**

1. Financial impact is only expected to be positive (royalties)
2. FPB not expected to have capacity to fulfill the role itself
3. FPB has already initiated legislative process to allow membership
4. FPB becomes part of multilateral institution and contributes to better internet governance
5. FPB ǁill iŵproǀe ďraŶd exposure through IARC usiŶg FPB’s logo
6. FPB ǁill haǀe iŶput iŶto IARC’s ĐlassifiĐatioŶ approaĐh
7. Being a member of international body will bring trust and legitimacy
8. Both UK and Australia have successfully implemented IARC
* Game/app content to be regulated and charged by IARC
* Films/serials and publications to be regulated and charged by FPB
* Recommended that publications charged in line with physical content due to lack of presence of online currently
* Eg. iTunes ZA would pay IARC monthly for game/app content and pay FPB for films/series
* Encourage contracting with IARC on voluntary basis – charge more (approx. double) through FPB

**Initial fee:** R1.4 mil

## Renewal fees:

|  |  |  |
| --- | --- | --- |
| **Number of apps/games** | **Monthly licensing fee** | **Licensing fee per year** |
| <5,000 | R175,000 | R2,100,000 |
| 5,000 – 49,999 | R350,000 | R4,200,000 |
| 50,000 – 99,999 | R525,000 | R6,300,000 |
| 100,000+ | R700,000 | R8,400,000 |

* Future consideration: Reduced fees for niche distributors (eg a few online games)
* Fee should be varied by size to be fair – consistent with consultations
* Number of titles was considered best indicator of size due to:
	1. Titles/hours directly relates to FPB effort & value of service
	2. Distributors will be hesitant to provide financial information
	3. Financial information can be skewed by business structures (perverse incentives)
	4. Number of titles is most readily available – less risk in estimating revenue
* Film and serials to be considered separately due to length difference (series approx. 5 times longer)
* Fees set to produce similar total revenue in 2017/18 to current tariff structure

Proposed annual fees:

|  |  |  |
| --- | --- | --- |
| **Number of apps/games** | **Films** | **Series** |
| 0 – 499 | R259.31 | R1,037.24 |
| 500 – 999 | R207.45 | R829.79 |
| 1,000+ | R165.95 | R663.83 |

* Fees for series 4 times for films due to length and reducing marginal difficulty of classification
* Fees for bands 2 and 3 are 20% less than preceding for benefits of scale and fixed costs
* Disadvantage: new distributors will pay less
* Advantage: encourage compliance as more fair
* Fees will necessitate annual content verification process
* To provide support for new entrants, informal market, small players (concern in consultations)
* Improved fairness vs ability to pay (remove barriers to entry)
* Size based on titles submitted in previous year – practically simple, also reduced fee for new entrant

## Recommend differentiating fees for small/medium/large by 50% differential:

* + Small clients still receive noticeable decrease despite recommended increase in classification fees
	+ Smaller differential would reduce support for small at expense of big
* Similar differential not possible for registration due to lack of info on size – but fee is small

Current split by client size:

|  |  |  |  |
| --- | --- | --- | --- |
| **Distributor size** | **Number of titles****submitted previous year** | **Proportion of****distributors** | **Assumed proportion of****fee income** |
| Small | Less than 5 | 62% | 20% |
| Medium | 5 – 99 | 34% | 50% |
| Large | 100+ | 4% | 30% |

* Revenue from classification/revenue will increase by 5.0% (R120k per year)
* Future consideration: exemption process for to allow small fees based on financials/ability to pay
* UK offers expedited classification at a premium

## Recommend expedited classification fee at 25.0% more

* FPB would need to determine achievable turnaround time
* Assumed 10% take-up and R60k – R70k additional annual revenue

Currently applied tariffs:

|  |  |  |
| --- | --- | --- |
| **Production location** | **Initial tariff** | **Hourly tariff thereafter** |
| Foreign | R2,243 for first 3 hours | R667 per hour |
| South African | R2,243 for first 5 hours | R1,007 per hour |

Concerns include:

* Average classification cost for series is 6 times more than film (length is 5 times more)
* Average cost to classify SA production is similar to Foreign due to higher hourly tariff

## Recommend that hourly rates are reduced & set equal so cost of classifying series is 4 times more than film

* Retailers are experiencing practical difficulties in processing registration/renewal per store

(eg different timing)

## Recommended that registration/renewal is processed once per retail group

* Fee will remain as is per store – fair as fee is based on size of client
* Admin burden will reduce for both FPB and clients
* Compliance may increase
* FP Act defines ISP as any person who carries on business of providing access to Internet by any means
* FPB’s ŵaiŶ registered ĐlieŶts are those proǀidiŶg IŶterŶet aĐĐess oŶ preŵises (eg internet cafes)
* Amendment Bill defines Internet Access Providers (IAPs) as persons who provide public access to internet-connected devices belong to provider
* Amendment Bill makes distinction between ISPs (as per ECT Act) and IAPs
* ISPs – Where 3rd parties supply information (e.g business centres and internet cafes)
* Section 18G(7) compels ISPs/IAPs to provide identity of person publishing photo/film depicting sexual assault or violence against children
* It is submitted that the Amendment Bill definitions better serve FPB
* But to avoid compliance net being too wide, **recommended that IAP definition revise to: those who provide**

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* Currently all of the following would have to register, pay fees and ensure compliance:
	+ Internet cafes
	+ Schools
	+ Universities
	+ Libraries
	+ Hotels with business centre, etc
* Research does not reveal compelling reasons for ISPs/IAPS to register with FPB and pay fees
* FP Act should however contain provisions placing legal obligations to assist law enforcement in prosecution of

crimes

* Fees structured relative to (above/double) cost of complying to reduce admin burden and encourage compliance Film content (penalty fee per title):

|  |  |
| --- | --- |
| **Offence** | **Number of film titles offered** |
| **0 - 499** | **500 - 999** | **1,000+** |
| * Failure to register
* Failure to renew license
 | R518.62 | R414.90 | R331.92 |
| * Failure to display classification decision
* Incorrect display of classification decision
* Failure to submit for classification
 | R43.22 | R34.58 | R27.66 |

Series content (penalty fee per title):

|  |  |
| --- | --- |
| **Offence** | **Number of series titles offered** |
| **0 - 499** | **500 - 999** | **1,000+** |
| * Failure to register
* Failure to renew license
 | R2,074.88 | R1,659.58 | R1,327.66 |
| * Failure to display classification decision
* Incorrect display of classification decision
* Failure to submit for classification
 | R172.87 | R138.30 | R110.64 |

* First penalty fee in table to be applied in step fashion (in line with licensing fees)
* Second penalty fee to be applied per title where there was a failure per month of failure to comply
* FPB can consider applying interest on late payment on monthly basis, but under common law

*in duplum* rules implies cumulative interest may not exceed capital amount of debt

|  |  |
| --- | --- |
| **Offence** | **Penalty fee recommendation** |
| Failure to register with FPB | Twice registration fee |
| Failure to display classification decision on classified content | Twice relevant classification fee |
| Incorrect display of classification decision | Twice relevant classification fee |
| Failure to renew distributor license | Twice renewal fee |
| Failure to submit content for classification | Twice relevant classification fee |

* + Similarly, double the related fee discourages non-compliance
* R8.1 mil additional revenue still needed over 5 years

## Recommend once-off increase of 40% in classification fees, because:

* + Clients (excluding small) generally noted that classification fees were insignificant
	+ Smaller clients will still receive decrease
	+ Revenue vs cost is low for classification relative to online licensing and registrations (would still be significantly lower)
	+ Revenue from other sources is very small – little ability to raise substantial additional revenue
* This would produce R6.0 mil additional revenue over 5 years (Still need R2.1 mil)
* **Recommend increasing tariffs (after initial increase) by CPI + 3.0%**

Alternatives:

* Increase all tariffs once-off by 9.3%
* Assume CPI increase of operational grant in 2020/21
* Gradual increase favoured over once-off due to improved planning ability and less once off impact on stakeholders

## Be cognisant of new formats (eg virtual reality) and how addressed through tariff regime

1. **Alternative means of online distributor size differentiation (eg hours of content)**

May be considered more fair

Will necessitate processes to collect necessary information

## Alternative means of other client size differentiation (eg financial)

Will need client support

Can consider exemption process based on financial information

## Monitor extent of online publications and need to reconsider tariff treatment

1. **More supportive fee structure for small online game/app distributors**

Eg, remove once off fees, increase renewal fees & introduce a smaller size band

## LARGEST TO SMALLEST RISK

|  |  |
| --- | --- |
| **Risk** | **Change that can be absorbed while remaining financially sustainable** |
| 1. Operational grant increase below CPI | CPI-2.6% increase for 2018/19-2020/21 |
| 2. Administrative complexity of changes | 2.0% increase in expenses |
| 3. Data inaccuracy causing lower than expected fee revenue | 20% decrease in fee income |
| 4. Growth in demand for FPB services | 20% increase in demand |
| 5. IARC royalties lower than expected | Can absorb impact of no royalties |
| 6. Poor industry perception (eg large clients) | Risk is not financial – risk of reduced compliance |
| 7. Reduced number of online distributors paying fees | Risk is not financial – risk of reduced compliance |
| 8. Growth in demand has larger than expected expense impact | Expenses increases by 1.75% for 1% increase in demand |
| 9. Growth in demand for FPB services by small players | 1150% increase in demand from small clients |

Thank you