

REPORT OF THE RAPPORTEURS GROUP TO THE DECEMBER MEETING OF WORKING PARTY 2/3

Purpose

The purpose of this document is to provide a text which members of SG 3 Working Party 2 can use as a basis for their continued work. It draws from the various contributions and interventions at the May meeting and the subsequent comments on the first and second drafts. It aims to represent the discussions and contributions to date, it does not set out to propose a final solution. A number of substantive issues have been raised in contributions to the rapporteurs group which the Working Party must consider before a solution can be developed. These issues, together with a list of other points arising from this document are set out in a further document which the Rapporteur will submit to the Working Party meeting.

Structure

- 1 The objective
- 2 The options and proposals
- 3 Discussion of options and emerging principles
- 4 Methodology issues
- 5 Transition issues
- 6 Data gathering, including case studies
- 7 Summary

1 The Objective

1.1 **Need for reform**

There was consensus at the May meeting that the current regime had to be reformed or modified to meet the challenges which the fast changing telecommunications environment was placing on it. It is necessary for Study Group 3 to progress the reform as a matter of urgency, but without destabilising the existing regime.

This need for reform and the supporting arguments were set down in a number of contributions, e.g. #2 from Secretary General, # 109 and 17 from UK, # 20 from the informal group of experts, # 19 from Telia and delayed # 15 from Russia, #21 from TINS, #24 from Korea and # 35 from Hong Kong Government.

It is clear that in the future there will not be one regime but rather a menu of regimes with carriers agreeing to use which ever regime, or regimes, which best suits a particular relationship. The alternative regimes being considered by Working Party 2 should be considered as supplementing the existing regimes.

In considering the potential reforms the following scenarios were noted :

- Between Liberalised and Liberalised
- Between Liberalised and Non liberalised
- Between Non liberalised and Non liberalised

In considering the **liberalised to liberalised** scenario it was argued that market forces will apply and therefore the role of the ITU will be very limited if existing at all. This position was supported by Contributions # 20 from the Group of Experts, # 17 from the UK, # 19 from Telia and delayed # 19 from Sweden, #21 from TNZI, # 32 from New Zealand. However, the ITU could usefully monitor the developments on these routes, in particular the impact on accounting/settlement arrangements, and communicate the developments to the ITU membership. (source: proposal by Linda Yu, Hong Kong SAR Government)

Also, there would appear to be a useful role for the ITU where a market is moving from a non- liberal to a liberal environment to:

- ensure governments are aware of the rapidly changing environment and of how this is impacting on the traditional settlements system
- develop and maintain understanding of the range of alternative systems that are likely to emerge in the new environment, as a way of assisting transition to new arrangements
- make recommendations where appropriate to assist in the transition and keep existing recommendations under review against obsolescence.

(source: Philip Allnut, Government of Australia)

The other two scenarios **liberalised to non-liberalised and non-liberalised to non-liberalised**, clearly require to be addressed by Study Group 3.

1.2 The need for cost orientation

The contributions from, Brazil, Hong Kong, Canada, KDD, USA, UK, Telia, Sweden, Mali, Russia, Australia, Korea, Japan, New Zealand, Aseta, France and the informal Group of Experts all endorsed the key objective of achieving cost orientation as set down in Recommendation D 140, as did numerous interventions from the floor. The point was made in May that if the current levels of rates were at or very close to cost then there would not be the pressures to reform the current accounting rate regime.

Contribution # 16, from the TSB, showed that the average accounting rate has been reducing at 3% per annum since 1988, the reduction in 1995 being 5%. If only those rates where changes have been made are considered then the reduction is 19.12 %. Compared with the reduction of 30% per annum in submarine cable costs, as shown in Contribution #2 from the Secretary General and the cost trend data assembled in the ITU/TeleGeography Inc. Publication " Direction of Traffic," clearly there is a long way to go if the target date of 2000 is to be achieved.

Recommendation D 140 said that cost orientation should be achieved in 5 years; if taken from completion of the Recommendation this is 1995 - 2000. The WTO have set the date of 2000 as the time when they will examine accounting rates. There is therefore a key deadline for Study Group 3 to aim for. If the ITU is to remain in control of the accounting rate regimes it is necessary for it to be able to demonstrate to the WTO that it has undertaken all the necessary reforms. If not, then, at least for those countries which are party to the WTO agreement, the WTO will establish the regime.

1.3 Governing Principles

Study Group 3 has to establish a set of principles which can form the basis for moving forward to cost orientated rates. Delayed contribution D 27 from Japan listed seven principles related to cost orientated settlement which could be adopted as a start point;

- continuity and viability of international telecommunications service
- transparency
- non-discrimination
- cost-orientated tariffing
- competition (compatibility with) (source: Neil Feinson, UK government)
- benefit to end-users as a result of reductions (clarification)
- ease of transition for developing countries
- minimum of regulation necessary to achieve the goal.

The above embraces the principles contained in D 140 and the principles of the WTO. They are also consistent with the discussion of the May meeting.

Additionally, the new regime should be conducive to improved efficiency and cost reduction and continue the current downward trend in settlement rates (Source: Vivienne Lucas, BT)

2 Options/Proposals

2.1 Current Regime

The current accounting and settlement regimes are set out primarily in the following ITU-T Recommendations ;

D 150

D 155

D 140.

and are underpinned by the International Telecommunications Regulations (ITRs). The point was made during discussion that the ITRs were approved in 1988 from work carried out in 1986/7. Therefore, given the massive changes to the telecommunications environment between their development and the present day the applicability of them to today's telecommunications environment must be questioned. Proposals have been made that the ITRs should be revised but, given the long time scale for such a process doubts were expressed that any revisions would be timely enough to be of value. Nevertheless, once the nature of reform has been agreed, the requirement for a revision should be assessed jointly with Working Party 1/3. (Reflecting various comments on this point).

2.2 Potential New Regimes

The following have been identified in contributions to Study Group 3.

2.2.1 Termination charge.

Two approaches to termination charges emerged :

Approach (a) as advocated in Contributions #14 Hong Kong Telecom International and #18 , St Vincent and Grenadines:

This would be one charge for all incoming traffic. The single charge would include transmission and switching and be set unilaterally by the destination at whatever level the destination country decided appropriate. The level of charge would be non-discriminatory and transparent. The rate would include any subsidies (see section 2.3.4 below- source: Philip Allnutt) and would be independent of routing i.e. the charge would be the same whether the traffic had originated in the sending network or had originated in a third country (Additional text to meet requests for clarification).

Approach (b) As advocated in delayed contributions; #13 Mali, #15 Russia, #24 Korea, #35 Hong Kong Government:

An unbundled Termination Charge, which would be transparent, cost based and broken down into the basic elements - transmission, switching and national extension, using a multilaterally agreed criteria for setting the levels. The possibility of a fourth element, subsidy, was addressed in contribution #4 from Brazil and D#23 from Australia. See section 2.3.4 below.

2.2.2 Settlement Rate

This would replace “revenue sharing” (i.e. a total accounting rate divided into component shares) with a settlement rate per minute (i.e. the level of payment to the destination) which would be bilaterally agreed, cost orientated in accordance with D 140 and could be unbundled into the basic elements - transmission, switching and national extension. As cost orientation is achieved, the present variation between the levels of per minute receipts incoming to any ROA would be largely removed. (Additional text to meet requests for clarification)

See contributions from; #9 France, # 17 UK, D#31 USA, D#23 Australia, D#24 Korea, D#35 Hong Kong Government.

2.2.3 Interconnection charge.

This regime would be most applicable in the liberalised to liberalised scenario and would supplement other accounting regimes.

In this regime the international ROA is provided with interconnection at one or more points within the destination ROA's national network. The destination ROA publishes a charge for carrying the call from the point of interconnect to the terminating point. Interconnection charges may be regulated by the national regulatory authority. The charges will be required to be cost based, transparent and non-discriminatory. The charges will be set at the same level independent of call origin, only varying according to the point of interconnection

The ROA originating the traffic would be responsible for all switching and transmission costs up to the point of interconnect .

(Source : Neil Feinson)

See contributions; #9 France, #17 UK, #10 Canada, #15 USA, #20 Group of Experts, D#23 Australia.

2.2.4 Leased Cost Routing and Hubbing

This is perhaps not an accounting regime but a result of the market forces which are now a major factor in international telecommunications. The ever growing number of new entrant players in the telecommunications environment look to routings and costs which best match their particular needs. Hubbing attracts new players, which, for economic reasons, cannot open direct relations with destination countries and must, to ensure profitability, choose the least costly route. This in turn puts pressure on incumbent operators to seek similar low cost options. (Consensus was that this paragraph should be retained).

The Working Party noted that the TAS Group were developing principles for the current practise and these may be suitable for global adoption.

See contributions; #9 France, D#21 TNZI, D#32 New Zealand.

2.3 Related principles

A number of related principles were addressed in the contributions to the May meeting :

2.3.1 Bilateral/ Multilateral requirement

There was emphasis in the majority of the contributions, and during debate, that whatever solutions are adopted that they should be based on bi or multilateral agreement and application.

The unilateral application of benchmarks whether for outpayments or inpayments was not acceptable. (Source : Neil Feinson)

There was however wide support for the possible development on a multilateral basis of benchmarks/target rates/ minimum and maximum ranges, and the establishment of related criteria.

See Contributions : # 4 Brazil, # 12 KDD, # 17 UK, # 19 Telia, # 20 Group of Experts, D# 15 Russia, D# 24 Korea, D# 27 Japan, D# 32 New Zealand, D# 35 Hong Kong.

2.3.2 Transparency

There was general acceptance that the payment levels under any new regime should be transparent (i.e. published), and the component elements (i.e. transmission, switching and national extension) making up the payment levels identified. In addition the methodology used to establish the levels should be identified.

In addition there was evidence of growing support that current settlement rates should also be transparent.

See Contributions : # 4 Brazil, D# 13Mali, # 14 Hong Kong, #20 Group of experts, #15 USA, # 12 KDD, D# 32 New Zealand, and interventions from Jamaica, Yemen and Bahrain.

2.3.3 Costing Methodology

A number of contributions addressed the question of costing methodology. The ideal solution would be a full cost study. However, it was accepted that the time scale for such a study would be far too long to be of value to this exercise, in addition the availability of data on a sufficiently global basis was doubtful. For such a costing exercise it would be necessary to identify a common base year, and given the time needed to answer a questionnaire and process the replies, the results would already be out of date before they were published.

Therefore, other possible methodologies have to be considered. Existing models include the TAS D500 Supplement and D 140 Annex A, for use on an individual basis. New proposals covered the use of surrogate costs, best practice, and long run incremental costs. **See section 4.**

See Contributions; # 17 UK, # 15 USA, # 19 Telia, D# 29 KDD.

2.3.4 Subsidy

A number of contributions and interventions addressed the issue of subsidies.

Many delegations stressed the need for developing countries to retain the high level of accounting rate as this generated the financial resources necessary to fund the development of their network and to help them meet their universal service obligation. Several comparisons were made between the low level of telephone penetration in developing countries when compared with developed countries.

Whilst recognising this need for financial resources, the counter argument was expressed that the accounting rate should be the true incurred cost of terminating incoming traffic. Further, to inflate accounting rates by such subsidies would only put greater strain on the existing correspondent relationship since new entrants would not be either prepared or able to pay these high rates and would hence look to other methods of terminating their traffic.

Comments were made that it is not acceptable to include these subsidies within the accounting rate since this falsely inflates the true cost of terminating a call. The point was also made that accounting rate out payments should be considered as a reimbursement of the costs of terminating incoming traffic and not as a direct source of revenue.

There was clear support that if they do exist then there should be total transparency of such subsidies: when a country considers it is appropriate to build in an additional amount by way of a subsidy - be it for network development, universal service obligation, or other telecommunications requirements. - then the amount should be clearly identified and bilaterally agreed, including the time scale for phasing out the subsidy. Contribution #4 from Brazil refers. (Additional text: clarification requested by John Keselica, USA).

3 Discussion of Options and emerging principles

3.1 Termination Charges vs Settlement Charge

3.1.1 Basic principles which could apply to termination charges are :

1. The termination charge would be paid to the ROA terminating the call.
2. The origin and destination ROAs would share the cost of international transmission, as now under D 150.
3. The termination charge would be independent of the origin of the traffic. Exceptions could exist for frontier relations.
4. The termination charge would be transparent and non-discriminatory.

3.1.2 The **arguments presented in favour** of such a system included:

- It would provide a totally transparent and non-discriminatory system.
- It would be independent of traffic balances, a factor which has made reductions in accounting rate levels difficult to achieve.
- By not involving the division of a total accounting rate i.e. 50/50 or some other ratio, it would be better able to focus on the cost of delivery, tariff balance and service development.

- Termination charges would eliminate the scope for arbitrage.
- Termination Charges would be set by carriers according to their own needs, and would take full account of delivery fees, cross subsidies, network development and other criteria seen as important by sovereign governments.

3.1.3 A number of contributions and interventions did however **argue against** the introduction of a system of termination charges where these were unilaterally set by the destination at one level. Those arguments included :

- With termination charges applying to all incoming traffic there would be no motivation, or mechanism, to set the charges at, or lower the charge to, cost based levels. This is a serious problem if there are no agreed target levels or criteria. (Source: Linda Yu)
- The self determination of the level of a termination charge could be considered as little different to the unilateral imposition of benchmarked out payment levels, Termination Charges being unilaterally set inpayments.
- Certain items proposed to be covered in the charge were considered not to be appropriate such as subsidies to cover universal service obligations and network development costs , and other costs not strictly relevant to the provision of the existing service. (Source Neil Feinson)
- With a single charge, the impact of any reduction, which would apply to all incoming traffic, would be so large as to mitigate against making a reduction.
- A single, non discriminatory rate would offer no incentive for better network management, quality improvements or capacity augmentation.
- Transmission costs do vary by route therefore a single rate could not be truly cost based.

3.2 Comparing Termination Charges and Settlement Charge :

- Settlement rate could be described as a bilaterally agreed termination charge.
- Neither would necessarily be the same for each incoming minute but if cost orientation achieved the difference should be small.
- The level does not have to be the same for each incoming minute to remove the scope for arbitrage, just in a small range reflecting cost differences.
- Cost based termination charges/settlement rates are in accordance with D 140.
- Unbundled and transparent settlement rates appear to be the same as unbundled termination charges.
- Transition to either appears to call for some form of multilateral guidelines addressing cost orientation of levels.
- The settlement rate would be unidirectional and therefore there would be no division of a through accounting rate.

3.3 Bundled vs Unbundled Termination Charges

An advantage of unbundled charges is that the separation of the international transmission, international switching and national extension elements helps operators to identify their costs more accurately. To impose the same bundled Termination Charge for all sources of traffic would be inconsistent with the principle of cost orientated charging in that international transmission costs vary. Nevertheless, bundled charges may be acceptable as the first step. (Source: Philip Allnut.) In fact, if the charges are cost

orientated, the issue of bundling or unbundling is less of an issue. (Source: comments by Deoraj Ramnarine, TSTT)

3.4 Conclusion

From the above, it could be concluded that bilaterally agreed, cost orientated, transparent, [unbundled] settlement rates would be an acceptable form of termination charges and a natural evolution of the present accounting rate regime through the application of D 140.

If this could be accepted, this leaves the key issues of :

- methodology for achieving cost orientation,
- time scale and provisions for the transition.

One point which would have to be addressed in any cost orientated regime is whether there should be different rates for specific categories of traffic with higher delivery costs than normal IDD e.g. traffic terminating on mobile terminals where there are additional delivery interconnection costs. Delayed contribution D 12 from Telecom Finland addressed this point.

4 Methodology

Existing methodologies are addressed in Recommendation D 140 Annexes A and C and in the TAS Recommendations. New proposals were made in contributions D# 31 USA, #17 UK and D# 29 KDD.

Whilst unilateral benchmarking was not accepted there was considerable support for studies to look at possible global/regional benchmarks; target rates; ranges. For these studies to be undertaken it will be necessary to obtain the base data via a questionnaire.

Additional information in relation to examining methodologies, and the impact of applying them, would come from case studies as proposed by France in # 9. **The ITU Council at it's June meeting agreed that a number of case studies should be undertaken as preparation for the second world telecommunications policy forum. These case studies will be jointly managed by ITU-T Study Group 3 and ITU-D . The proposed format of these studies and call for expression of interest in preparation of these studies can be found on the ITU Home Page : http://www.itu.int/intset/call_for/callmain.htm.**

5 Transition Issues

The requirement for a transition from current rates to cost orientated rates was raised in a number of contributions - # 4 Brazil, # 10 Canada, # 20 Group of Experts, D#25 USA, D# 27 Japan, D# 28 KDD, D23 Australia

Two particular points were raised. Firstly the need to provide assistance in the form of expert training. Secondly was the need to provide transitional support for developing countries. One possibility was some form of partnership with external sources e.g. the World Bank, may be prepared to co-operate in developing systems which would protect developing countries from the sudden financial impact of dropping to cost orientated accounting rates.

Developing countries may require time to adapt to changes in view of the negative impact on settlement revenues which may arise from accounting rate reform. A negotiated process should be the way, not unilateral action (Deoraj Ramnarine)

However, again, it is essential to have data on which to assess the scale of impact of moving to cost orientated rates and hence the size of the problem faced by individual developing countries. The case studies referred to above will give some idea.

6 Data Gathering

Many contributions and interventions stressed the need to obtain more data on the application of the existing D.150 regime, together with the rate of progress with implementation of D 140. At present the only information on levels of present accounting rates was that published by a few countries, and the limited information obtained via the TSB Questionnaire. There has been a clear consensus that any new regime should be transparent and non-discriminatory. Many interventions expressed the view that for such a regime to be agreed and implemented, there would first have to be greater transparency of the existing regime. In order for targets or benchmarks to be established on a multilateral basis and for transition arrangements and timescales to be defined, there has to be a willingness on the part of ROAs to provide data on current settlement rates. A minimum initial requirement could be for each ROA to provide its highest, lowest and mean per minute telephone receipt to enable an initial analysis and first proposals by SG3. A draft model for data gathering is attached at annex 1.

(Source: Based on comment from Vivienne Lucas).

7. Tasks and Timetable.

December 1997	White contribution from Rapporteur Group debated; Definitions agreed; Tasks and Timetable agreed including data gathering requirements
May 1998	Draft recommendation(s) considered; data analysis commenced; case study results addressed
December 1998	Draft recommendation and guidelines agreed for transitional period
xxxx 1999	Recommendation adopted; implementation commenced.
1999- 2003	Implementation.

(Source: various)

THE NEXT STEP

For the development of the above document, members of the rapporteurs group are invited to input to this document with the objective of developing a set of recommendations to the December meeting.

In addition, the group should :

1. Agree the tasks and timetable - section 7 refers.
2. Agree on a definition of a termination charge regime - section 3 refers
3. Consider the available and proposed methodologies for achieving cost orientated rates with the aim of agreeing the way forward - **more contributions required.**
4. Establish a questionnaire which would seek data to enable the necessary studies to be undertaken - see draft attached.

They key to rapid reform will be the derivation of what any termination charges, settlement rates, or interconnection charges might be. It may be possible for a number of administrations/ROAs to agree collectively to adopt a system between them which goes some way towards reform in advance of seeing the results of lengthy modelling. While national sovereignty needs to be preserved, guidelines could be quickly developed which could be incorporated into these agreements. These might include, average inpayment or lowest inpayment.

Annex : 1

Annex 1

**PROPOSED MODEL FOR DATA GATHERING BY SG3
TO PROGRESS ACCOUNTING RATE REFORM**

Country:..... ROA..... Contact

Details.....(name, position, tel, fax,e-mail)

Data as at 1 January 1998

Number of IDD routes:.....of whichare direct,..... are indirect

(please tick where applicable)

1. Information about your current settlement rates*

- to the ITU Secretariat in confidence?
- to the ITU for inclusion in the www. pages?
- to ROAs who agree to provide the same?
- with origin disclosed/anonymously?

2. In one or more of the following forms:

a) actual settlement rate* route by route (direct routes shown separately from indirect routes)

b) highest settlement rate*

- on direct routes
- on indirect routes

lowest settlement rate*

- on direct routes
- on indirect routes

weighted average settlement rate*

- on direct routes
- on indirect routes
- all routes

(if full and reduced rates exist, supply both)

c) Actual settlement rate* for top 20 routes and weighted average settlement rate all routes (if full and reduced rates exist, supply both)

Percentage of traffic represented by top 20 routes

- incoming
- outgoing

(for latest 12 months available - specify), and according to direction of account)

d) weighted average settlement rate incoming

- direct routes
- indirect routes
- all routes

weighted average settlement rate outgoing

- direct routes
- indirect routes
- all routes

* defined as the amount RECEIVED per minute of traffic ie destination share.

Notes: all rates to be shown in SDRs. To convert gold francs to SDRs use 3.061 gfcfs = 1 SDR, to convert \$ into gold francs use the 1/12/97 rate of

Annex 2

Source : Chairman Working Party 2/3

Subject : ACCOUNTING RATE REFORM - ISSUES FOR CONSIDERATION

Given the range of views which have been expressed in relation to accounting rate reform it is clear that if real progress is to be made at the December meeting of Working Party 2/3 then it will be necessary for all sides to agree on various compromise positions. Failure to reach compromise, and recognising the time scales for developing and agreeing a Recommendation, it will not be possible to adopt a Recommendation before the end of 1999.

The key areas the issues which need to be addressed are listed below. A number of them can be considered whilst considering the working definitions of Termination Charge and Settlement Rate:

1. Working definition of TERMINATION CHARGE:

This is a charge, i.e. price per minute of traffic, for the termination of traffic. The price covers three components :

- a) The international circuit section (half circuit) provided by the destination administration.
- b) The use of the international exchange (gateway switch).
- c) The national extension (switches and transmission facilities up to and including the local loop).

The issues which need to be addressed are :

1.1 Are the three components combined into one single charge, "bundled" or charged individually, "unbundled"? A further alternative is where the national extension and international exchange are aggregated into a single charge, with the international circuit section charged separately.

1.2 Is the charge set unilaterally by the destination, using its own criteria or, by using multilaterally agreed criteria?

1.3 Is the level of the charge the same in all relations i.e. independent of the call origin or does it vary with differences in cost? In particular, does the international circuit element vary in relation to distance, medium i.e. satellite or cable?

1.4 Is the level of charge independent of call routing i.e. the same whether the call had originated in the country from which the call is received or whether originated in a third country?

1.5 *Taking account of the principles listed in 1.3 of the Rapporteur group report to Working Part 2, a definition of a termination charge could therefore be :*

A charge established by the destination using multilaterally agreed criteria, to ensure cost orientation, applied on a non-discriminatory basis and fully transparent.

The charge may be unbundled. The charge covering the international exchange could be bundled with the charge for the national extension to form a single charge applied in all relations, given that neither component would vary with call origin.

The charge for the international circuit could vary dependant on call origin, to take account of the differences in transmission costs.

2. SETTLEMENT RATE (CHARGE)

The settlement rate could be defined as for the termination charge above except that the rate would be bilaterally negotiated.

3. INTERNATIONAL INTERCONNECTION

In this regime, the origin international operator is provided with interconnection at one or more points within the destination operators network. The costs involved in accessing the interconnection point, or point of presence, are covered by the originating operator. International Interconnect is only an option where it is in accordance with the regulatory regimes applying both in the origin and destination countries.

A cost-based charge is set for the termination of traffic from the point of interconnect to the terminal point. This charge will vary depending on the point of interconnect in the destination network. The charge is independent of the call origin. The charge may be set by individual operators or by the appropriate national body, in accordance with an agreed costing methodology. Interconnection charges are transparent and non-discriminatory.

4. TRANSPARENCY AND NON-DISCRIMINATORY are key to any new accounting regime, possible definitions could be:

4.1 TRANSPARENCY

In the context of international accounting, transparency is taken to be the availability of, or access to, an ROAs termination charges or settlement rates for all its international relations. The methodology applied in developing these “charges” should also be available but the actual underlying cost details do not have to be disclosed.

4.2 NON-DISCRIMINATORY

Carriers shall apply similar conditions in similar circumstances to carriers in other countries providing similar services. e.g. The same price is charged independent of call orientation or routing, unless variation in costs justify a different price.

5. SETTING MULTILATERAL CRITERIA AND BENCHMARKS

Is there agreement that a “best practice” approach is the most practical solution? How would best practice be defined?

6. WTO

To what extent does the WTO activities have to be reflected in any new or revised Recommendation?

7. SUBSIDIES

How should the issue of “subsidies” be handled? How should they be defined?

8. ITRs

Revision of the International Telecommunications Regulations, the need to revise the ITRs is a topic for Working Party 1 taking account of the work of Working Party 2.

9. TRANSITION REQUIREMENTS

Recognising the need for transitional support for developing countries, what form should this take, and over what time scale?