Decision

Decision on short-term interventions to address risks to consumers from market volatility

Subject	Details
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From 15 December 2021 to 17 January 2022, we consulted on a range of potential temporary measures to enable domestic suppliers to better manage risks created by current wholesale market volatility, which could lead to higher costs for consumers in the event of further significant supplier exits from the market.

This document describes our decision to introduce two measures that, after consultation, we believe are in consumers' interests. These are as follows:

- A requirement for suppliers to make all tariffs available to new and existing customers
- A requirement for suppliers to pay a Market Stabilisation Charge when acquiring new customers.

These measures will come into effect on 14 April 2022 on a temporary basis, to address the risks to consumers in the short term from ongoing wholesale market volatility, in advance of enduring reforms coming in later this year. On 4 February 2022 we launched a consultation on changes to the price cap methodology that will enable better handling of market volatility on an enduring basis, while continuing to protect consumers.

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Executive summary

The unprecedented rise in global energy prices continues to put severe strain on energy markets. As the regulator of gas and electricity markets in Great Britain, Ofgem has worked at pace to protect consumers. Our open letter dated 15 December 2021 set out the steps we are taking to manage this situation in the interests of energy consumers now and in the future.

To address the issues raised by high and volatile wholesale energy prices on an enduring basis, we are reforming the price cap methodology and putting in place an enhanced regulatory approach to ensure energy suppliers pursue sustainable business models, minimising risks to customers and the market.

Temporary interventions to address risks to consumers

On 4 February 2022, we published a consultation on potential adjustments to the default tariff price cap methodology[1] to enable it to better handle market volatility, while continuing to protect consumers. We intend reforms to be in place by October 2022, but this leaves considerable risks of consumer harm in the meantime. Markets remain volatile and there is significant uncertainty as to wholesale price movements in the coming months. In the face of such uncertainty, domestic suppliers, even if well hedged, are exposed to potentially large losses if wholesale prices change significantly in either direction.

In response to consultation, stakeholders broadly agreed with our assessment of the risks to consumers and a majority felt that it would be in consumers' interests for Ofgem to intervene to mitigate these risks. We want to avoid the risk that consumers end up paying more in the longer run due to the costs involved if more suppliers exit the market in a disorderly way, coupled with the negative impacts of weaker investment, innovation, and competition in the retail energy market if suppliers face large and unpredictable losses.

Considering consultation responses, we have decided to introduce two temporary measures to help further stabilise the retail market by addressing the risks posed to consumers by the current extraordinary market conditions and, in particular, the risks associated with sharply falling energy prices.

[1] https://www.ofgem.gov.uk/publications/consultation-medium-term-changes-price-cap-methodology

Firstly, we will introduce a requirement for suppliers to offer all their tariffs to existing as well as new customers. This will help to stabilise the market in the short term by acting as a break on unsustainable price competition when cheaper tariffs return and customer switching picks up again. It will also limit price discrimination by suppliers and help to improve consumer trust and confidence in the retail market after the challenges of this winter, improving access to cheaper tariffs for consumers who may be less willing or able to switch supplier, particularly those in vulnerable situations.

Secondly, we will introduce as a backstop measure a Market Stabilisation Charge, to ensure that energy companies who have done the right thing by purchasing energy for their customers in advance are better able to recover more of their costs if we see a sharp fall in wholesale prices. This charge, payable by suppliers gaining new customers to suppliers losing them, will only take effect if wholesale prices fall significantly below the level used to set the price cap from April. In the event that the charge is triggered, it will reduce to some degree the cheapest tariffs available in the market; however, there will still be significant savings available to active consumers looking to switch.

Taken together, these measures will help suppliers to better manage, on behalf of consumers, the risks posed by severe energy price volatility and so mitigate the potential costs to consumers if wholesale prices fall significantly. In this way, they will reduce the potential for further significant supplier failures – with the associated disruption and costs for consumers – and promote investor confidence in the retail energy market so as to attract the investment necessary to support the achievement of net zero. As such, we believe that they are necessary and proportionate and in consumers' interests. We expect suppliers to work constructively with Ofgem to implement these temporary measures.

These measures will come into effect on 14 April 2022. Both are designed to be temporary – the intention is that they will fall away this Autumn as soon as the risks they are protecting consumers from are adequately addressed by reforms to the price cap. Nevertheless, we will have the ability to extend each measure through next winter if significant risks remain. And given the strong stakeholder support for making all tariffs available to new and existing customers, we will evaluate its impact, with a view to deciding whether it should become an enduring feature of the retail energy market.

We have decided not to implement the option of allowing exit fees on certain Standard Variable Tariffs. This is not our preferred option compared to the two measures we are implementing because it is less well targeted and could result in poorer distributional outcomes. However, we do not rule out pursuing this option in future if we believe it is in consumers' interests to do so.

1. Introduction

Context

1.1 The unprecedented and unexpected rise in gas and electricity prices since last Autumn has put energy markets under severe strain. Ofgem set out in an open letter published on 15 December 2021 the steps we are taking to manage this situation to protect the interests of consumers now and in the future.

1.2 Current wholesale market volatility means that energy suppliers face an increased challenge of managing risks in buying energy for their domestic customers. This could lead to poor outcomes for consumers, for example significant additional costs in the event of further disorderly supplier exits from the market.

1.3 To reduce these risks to consumers, Ofgem has already taken action to stabilise and reform the retail energy market and on 4 February 2022 we announced that we are moving ahead with major reforms to increase retail market resilience.2

1.4 These changes will establish more comprehensive risk management in the sector, protecting the interests of consumers, providing greater certainty for investors and strengthening the resilience of the sector. Nevertheless, these measures alone may not be sufficient to mitigate the risk of market volatility in these unprecedented times.

1.5 As a result, we consulted on a range of potential temporary measures to enable domestic suppliers to better manage these risks on behalf of consumers, for example in the event of wholesale prices falling sharply. We stated that Ofgem is only considering these measures due to the severe price volatility we are seeing in energy markets and that we would need to be satisfied that any measures are in the interests of consumers.

1.6 We consulted on three intervention options that could be taken forward in the event that severe risks to consumers look likely to materialise:

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[2] Reforms include: modifying supply licences to allow us to recalculate the price cap level outside of our routine six-month period in exceptional circumstances; strengthening our ability to assess the sustainability of growing suppliers and to scrutinise trade sales and significant commercial and personnel changes; and consulting on proposed adjustments to the price cap methodology to ensure it continues to protect customers, while allowing suppliers to recover their efficient costs during times of increased energy price volatility.

- **Option 1:** Requiring suppliers to make all tariffs available to new and existing customers[3]
- **Option 2:** Allowing suppliers to charge exit fees on certain Standard Variable Tariffs
- **Option 3:** Requiring suppliers to pay for a Market Stabilisation Charge when acquiring new customers

1.7 We welcomed stakeholder views on the potential scale and timing of the risks to consumers posed by current market volatility, the case for intervention to protect consumers' interests and the nature of any such intervention. The remainder of this document summarises the responses we received to consultation and sets out our decisions on how to proceed:

- Chapter 2 sets out our updated view on the nature, scale and timing of risks posed by current market volatility, and our assessment of whether the potential harm to consumers is sufficient to warrant intervention.
- Chapter 3 sets out our decisions on the options for temporary intervention to help protect consumers' interests and why we think these are justified to mitigate the risks identified.

Related publications

1.8 Ofgem Open Letter 15 December 2021

https://www.ofgem.gov.uk/publications/building-energy-market-resilience

1.9 The consultation document relating to the review of potential short-term interventions to address current wholesale market volatility:

https://www.ofgem.gov.uk/publications/statutory-consultation-potential-short-term-interventions-address-risks-consumers-market-volatility

[3] We have amended the name of this option slightly in this decision document to align with the policy and licence condition drafting consulted on, to provide clarification that we intend this measure to apply to all tariffs, as opposed to *new tariffs* which was an incorrect reference in the consultation document.

1.10 This consultation and resulting decision has been made as part of a wider package of measures to stabilise the retail energy market and protect consumers:

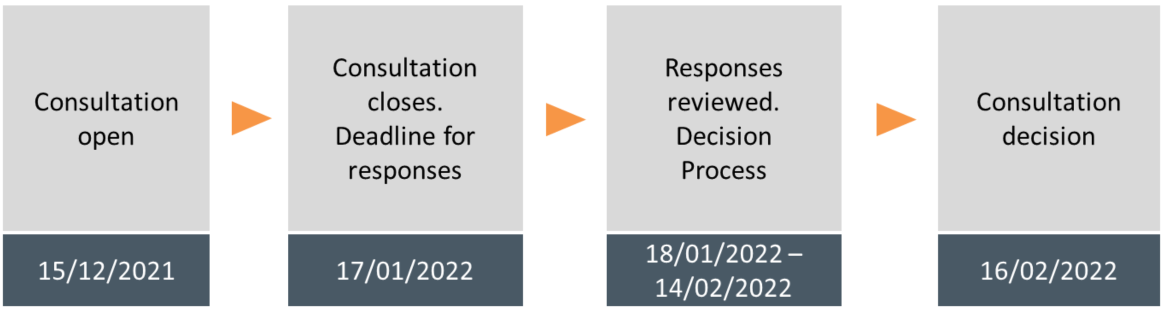
https://www.ofgem.gov.uk/publications/overview-4-february-2022-price-cap-decisions

Our decision-making process

1.11 We launched a statutory consultation on 15 December 2021. This was not preceded by a policy consultation, due to the urgency and pace required to implement any intervention deemed necessary, to address the risks we have identified to take effect from 14 April 2022. The consultation was accompanied with statutory notices of our intention to modify licences.[4]

1.12 The consultation closed on 17 January 2022 with 23 responses received from stakeholders – 8 confidential and 15 non-confidential. (This includes a number of formal responses received after the consultation deadline, which we have also considered.)

Figure 1: Consultation Stages



[4] Statutory consultation document, non-confidential responses and licence notices published here: https://www.ofgem.gov.uk/publications/statutory-consultation-potential-short-term-interventions-address-risks-consumers-market-volatility

Your feedback

Consultation Feedback

1.13 We have published non-confidential responses to this consultation on our website at http://www.ofgem.gov.uk/consultations.

General feedback

1.14 We believe that consultation is at the heart of good policy development. We are keen to receive your comments about this report. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall quality of this document?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Are its conclusions balanced?
5. Did it make reasoned recommendations?
6. Do you have any further comments?

Please send any general feedback comments to retailpolicyinterventions@ofgem.gov.uk.

2. Risks to consumers from continued wholesale price volatility

Section summary

In our consultation, we set out our view that domestic consumers face short-term risks over the next 6-12 months from volatility in the wholesale market. Stakeholders broadly agreed that we had characterised the risks correctly, though there were differences of opinion about their magnitude. Some stakeholders argued strongly that we should intervene to mitigate the risks, with some others arguing that this was not necessary or proportionate, while highlighting the potential for unintended consequences.

This section summarises the stakeholder feedback we received, and our updated assessment of the risks to consumers from wholesale market volatility.

2.1 In our consultation we set out our main assessment of the risks to consumers from continuing volatility in energy markets. In the face of significant uncertainty as to wholesale price movements over the next 6-12 months, domestic suppliers are exposed to potentially significant losses if wholesale prices change significantly in either direction. If prices rise sharply, millions of domestic consumers who would normally take a fixed-term contract instead choose a standard variable tariff at the (cheaper) price cap level, which suppliers may not have anticipated or hedged for. If prices fall sharply, those consumers move off the standard variable tariff to now cheaper fixed-term contracts, leaving suppliers potentially facing losses on the energy they had purchased for those consumers. This makes the task of managing these risks on behalf of consumers very challenging.

2.2 If suppliers are not able to recover the legitimate and efficient costs that they have incurred in purchasing energy for their customers, there is the potential for major financial losses for suppliers. These losses could be sufficiently high that some suppliers could exit the market in a disorderly way, resulting in significant costs being mutualised across all consumers. Even if suppliers do not exit, the scale of loss could be seriously detrimental to the attractiveness of the retail sector for investors. This could mean loss of competitive pressure between remaining suppliers, and damage to investment flows into the market. All of which could lead to lower innovation and poorer outcomes for consumers in future.

2.3 In this chapter, we summarise the views of consultation respondents on our assessment of the risks to consumers and on whether intervention is warranted in the interests of consumers. We also set out our revised assessment of these risks.

Stakeholder responses

2.4 Stakeholders broadly agreed with our assessment of the risks to consumers from continued wholesale market volatility. However, there were mixed views on the scale of these risks and how far reaching their effects are. Some respondents thought that we had not considered all the risks that could arise.

2.5 Large suppliers felt that we had correctly identified the risks to consumers. However, some thought we had not identified all the risks. For example, one supplier thought we should have considered the impact of all scenarios simultaneously. Another thought that the impact assessment was imbalanced because it focused on short term, quantifiable effects and did not focus as much on harder to quantify longer-term impacts on investor confidence, innovation and competition. However, they did accept the difficulty of carrying out this type of assessment. One respondent suggested that suppliers could exit the market voluntarily in the face of significant losses and not just in a disorderly fashion. Another felt that we had not fully acknowledged the issues with the price cap that prevent suppliers from recovering losses in the face of wholesale market volatility. Finally, three respondents encouraged us to pay particular regard to the importance of investor sentiment. They argued it is crucial that investor confidence is maintained, in particular to support the drive to net zero emissions.

2.6 Small and medium suppliers also broadly agreed that we had characterised the risks correctly. One respondent suggested we may have over-estimated the potential impact and that other interventions we are considering may help to mitigate it.

2.7 Consumer groups and other respondents generally agreed that wholesale market volatility presented risks to consumers. One respondent suggested that if suppliers' revenues fall, they may reluctantly reduce customer service levels. Another suggested that we had focused too much on price impacts. They suggested we had not paid enough attention to the potential loss of consumer confidence in the energy market if rapid falls in wholesale prices do not result in immediate reductions in tariff prices.

2.8 In our consultation, we invited stakeholders' views on whether Ofgem should intervene to mitigate the short-term risks to consumers of wholesale price volatility. We said the bar for intervention will be high and that we expected to know more in the new year about the risks consumers could be facing.

2.9 Large suppliers agreed that we should intervene to mitigate the risks. One suggested that appropriate measures were needed to prevent supplier exits and to protect consumers' interests until the market could stabilise. Another said that intervention was warranted to protect the financially vulnerable and those less likely to switch from paying the costs of supplier failure and market instability. Finally, one respondent said that intervention was essential and required flexible measures that could be deployed if market conditions deteriorate further.

2.10 Smaller suppliers had a mix of views. One said that we should intervene on the basis that acquisition pricing benefits only the most engaged consumers and eventual supplier failures increases costs paid by all consumers. Two said we should intervene but only if we can ensure the measures are proportionate. One of these also said we should intervene but only if we can minimise the impact on fair competition and do not distract from the development of more enduring solutions. Finally, one respondent said that other interventions we are implementing, particularly on improving financial resilience and pausing new entry, should reduce (though not eliminate) the risks.

2.11 Consumer bodies did not think that intervention is justified. One said that they wanted minimal changes to the market. Another said that the proposals could have negative impacts on consumers and agreed with the high bar for intervention. One said it is important to consider the impact of the interventions both individually and in the round.

Ofgem response

2.12 We recognise that there is a huge amount of uncertainty in what will happen to wholesale prices over the coming months. Our assessment of impacts is framed by this uncertainty. The nature of stakeholder comment reflects this as well – that we have identified the risks to consumers, but that it could manifest in different ways and to different degrees. **Overall, taking stakeholder feedback into account, we are satisfied that we have identified the main risks that wholesale market volatility presents to consumers in the short term**. These are (a) major supplier losses, driving supplier exits, (b) damage to investor sentiment, leading to reduced investment flows into the retail market, and (c) poorer outcomes for consumers, particularly from higher prices due to mutualised costs and lower levels of innovation and competition in the sector.

Updated impacts

2.13 We have updated our assessment of supplier and consumer impacts since we published our consultation. We have used in our modelling updated supplier financial information and hedging data, provided to us in supplier responses to our Requests for Information.

2.14 Our updated assessment of the impact on suppliers in different scenarios[5] is as follows:

- Under the falling prices scenario, we estimate supplier losses could be £1.0-£1.3bn (revised from £0.1-1.4bn).
- Under the rising prices scenario, we estimate losses could be £0.8-1.4bn (revised from £1.5-7.5bn).

2.15 Such losses would be very significant as they could lead to further supplier exits and damaging impacts on investor confidence, innovation and competition, all of which would lead to poorer outcomes for consumers in the longer term.

Consumer impacts

2.16 When wholesale prices fall, we want consumers to benefit from lower bills in a timely manner. In a falling prices scenario, these savings could be significant. Nevertheless, we also want to avoid the risk that consumers end up paying more in the longer run due to the costs of suppliers exiting the market because they are unable to recover costs they have incurred in serving customers protected by the price cap. Consumer costs could also arise due to extra allowances in future price cap periods to make up for supplier losses. Such losses could also have damaging effects on investor confidence, innovation and competition. As such, there is a balance of costs and benefits to current and future consumers to be considered here.

2.17 Since consultation, suppliers have provided updated information which shows they have increased the proportion of their Standard Variable Tariff (SVT) demand for which they are hedged. However, under a core falling prices scenario, whilst our financial modelling suggests a low risk of large suppliers failing (so we use a conservative estimate of up to £0.1bn from mutualised SoLR costs), there remains a significant risk of financial conditions leading to a large supplier exiting, potentially voluntarily – any such exits could be costly for consumers, and damaging to consumer confidence.

2.18 In a rising price scenario, consumers would likely see no savings benefit from switching as the cheapest tariff would be the price capped SVT. However, we have changed our view on the potential for supplier exits and mutualised costs under a rising scenario.

[5] Note we have updated the scenarios to reflect changes in wholesale prices since consultation. These are: Falling prices – 50p/therm; and Rising prices – 300p/therm. We have removed the Steady scenario to focus on Rising and Falling prices.

While we would still expect to see more customers drift off Fixed Term Contracts (FTCs) and onto Standard Variable Tariffs (SVTs) if wholesale prices rise, increased hedging has reduced the potential losses to suppliers. Consequently, it also reduces the potential for disorderly supplier exits and the resulting mutualised costs. We have therefore revised down our estimate of consumer loss to £0.0-0.2bn (down from £1.8bn-2.6bn at consultation). Nevertheless, as in the falling prices scenarios, there could be significant longer-term damaging effects on investment, innovation and competition if suppliers experience significant financial losses, which could add to costs for consumers.

Distributional considerations

2.19 We have not changed our view that low income and vulnerable consumers stand to benefit less from the savings available from switching to cheaper tariffs in a falling price scenario. This is on the basis that these consumers have historically been less likely to switch tariff and more likely to remain on SVTs than other consumers. Furthermore, any costs to consumers, for example from supplier exits or additional price cap allowances, would fall disproportionately on this group.

Summary

2.20 We consider that the overall assessment of risk under a falling price scenario is comparable to what we set out in our consultation. Active consumers will benefit from lower prices if they switch to cheaper FTCs, which would lead to major losses for suppliers who have already hedged for their SVT demand.

2.21 We remain concerned that, in a scenario of rapidly falling prices, some suppliers may either fail or choose not to bear these losses and exit the market. This could lead to significant costs to consumers (eg through the use of the special administration regime for one or more larger supplier exits, or further suppliers leaving the market through Ofgem's supplier of last resort process), and damaging impacts on competition and investment.

2.22 This could significantly harm consumers' interests, due to lower levels of innovation in products and services in the retail energy market and weaker competition leading to higher average price levels. These longer-term effects are less tangible and hard to quantify but could be very significant and outweigh any short-term benefit to consumers.

2.23 We have changed our assessment of the magnitude of risk under a rising price scenario. As suppliers have hedged more, we think it has reduced the potential for consumer costs and supplier losses. However, risks do remain and suppliers remain exposed to potentially significant losses under both rising and falling price scenarios.

2.24 In our overall assessment, we are weighing up the potential short-term savings that active consumers could make from switching against potential longer-term costs for all consumers, particularly those that are in vulnerable circumstances, from socialised costs of supplier exits, and lower levels of investment, innovation and competition.

2.25 We are planning to reform the price cap, potentially introducing quarterly price cap changes from October, making the price cap more resilient at times of price volatility. But we remain concerned about the risks if prices fall rapidly, which could happen before price cap reforms, and our work on improving suppliers' financial resilience, can take full effect.

2.26 **On balance, therefore, we consider that intervention is proportionate and justified to protect consumers' interests during a period of potential wholesale market volatility.** Action now will help to protect all consumers (particularly inactive, low income and vulnerable) from the potential costs of disorderly supplier exit and will help to maintain investor confidence in the retail sector at a crucial time for the sector's transition to net zero.

3. Options to mitigate risks to consumers

Section summary

This chapter sets out stakeholder responses to the short-term and temporary measures we consulted on as options for addressing the risks to consumers identified in the previous chapter, and states our position on what would be a reasonable and proportionate response to these risks.

3.1 This chapter sets out the options we consulted on for responding to the risks to consumers outlined in Chapter 2. This includes the default option of taking no further action beyond the measures we have announced to adjust the price cap for April 2022 and improve financial resilience among new and growing suppliers.

3.2 Our consultation asked which of these possible interventions, if any, would be most effective and proportionate in addressing the risks identified in consumers' interests. For each option, we asked whether we had identified the relevant benefits and impacts on consumers and the market.

3.3 We summarise the responses received to consultation against each of these options, along with our updated assessment of the expected impact, and our decision on how to proceed.

3.4 As these interventions could result in 'significant impact' on the domestic supply of gas and electricity markets (as described under the criteria in s.5A of the Utilities Act 2000), we have also updated the Impact Assessment published in our consultation document.

3.5 This represents our best assessment of impacts, reflecting the uncertain conditions in the energy market at the current time, and which we consider to be proportionate in the time available.

Do Nothing

Proposal

3.6 In our statutory consultation, we noted that Ofgem is already taking actions to stabilise and reform the retail energy market and that a number of these will help to mitigate the risks to consumers identified in Chapter 2. Chapter 1 outlines the decisions we have taken alongside this document in this respect. These include: modifying supply licences to allow us to recalculate the price cap level outside of our routine six-month windows in exceptional circumstances; and strengthening our ability to assess the sustainability of growing suppliers and to scrutinise trade sales and significant commercial and personnel changes.

Stakeholder response

3.7 Consultation respondents mostly recognised that, taken together, these measures would help to restore stability in the market. This included the enhanced measures to improve supplier financial resilience and the temporary 'pause' to the assessment of applications for new supply licences. Nevertheless, as set out in Chapter 2, the majority of respondents felt that these actions would at best only partially mitigate the risks to consumers in advance of enduring reforms coming into effect and that intervention in the short term was therefore justified in the interests of consumers.

Ofgem decision

3.8 While the bar for intervention by Ofgem is high, **we consider that it would be inappropriate for us to do nothing further to address the risks to consumers identified here.** Rather, we consider that the scale of the risks posed by continuing wholesale market volatility is sufficient to warrant intervention in the interests of consumers. Our discussion of the intervention options below compares them to this 'do nothing' option.

Option 1 - Requiring suppliers to make all tariffs available to new and existing customers

Proposal

3.9 In our statutory consultation, we proposed a requirement for domestic suppliers offering tariffs for the acquisition of new customers to make them available to existing customers as well. We said this would be a temporary measure, which could be implemented from April 2022 until the end of September 2022, unless the Authority decided to extend it by up to a further six months.

Stakeholder responses

3.10 A large majority of stakeholders favoured implementation of this measure. Most agreed that it would help bring some stability in the energy market, by temporarily reducing the intensity of price competition between existing suppliers and so mitigate against unsustainable pricing and major supplier losses. Some stakeholders argued that this measure would also have wider benefits, including increasing consumers' trust and confidence in the retail market. Indeed, quite a few respondents argued that this measure should become an enduring feature of the retail energy market.

3.11 Some stakeholders were opposed to this measure; they argued that it would be ineffective at mitigating risks in a falling price scenario, would distort competition between suppliers and would increase the risk of financial loss for some suppliers by reducing their ability to respond to competitors' offers without potentially cannibalising their own revenues through greater internal switching. For example, some respondents were concerned that the measure would impact less on suppliers with less engaged customer bases, fewer SVT customers or who have hedged less well for this Summer. Several price comparison websites (PCWs) also opposed this measure on the basis that it would reduce the level of savings available to active switchers, for example through new, exclusive tariffs.

3.12 In terms of wider benefits, some stakeholders argued that this measure would help increase consumers' trust and confidence in the retail market, during what could be a difficult time for them to consider the best course of action with their energy supply and when perceptions of the risks of switching may be high. One respondent argued that the over four million households who have been through the Supplier of Last Resort (SoLR) process in the last year may be more reluctant to switch supplier in the future given their experiences. Furthermore, they commented that greater transparency and the ability to access good deals will be crucial to consumers in being able to manage their energy costs in the coming months owing to continued energy market volatility.

3.13 A number of respondents argued that this measure would also give consumers more confidence that they are not being unfairly penalised for their loyalty by giving them the opportunity to benefit from tariffs currently only offered to new customers. A consumer body considered that this measure could particularly benefit vulnerable consumers, many of whom may struggle to switch suppliers for a range of reasons including outstanding debt, risk of failing credit checks or fear of losing access to the Warm Home Discount.

3.14 Two larger suppliers commented that the proposed licence modification, as drafted, may unintentionally prevent suppliers from continuing to offer special prices to their existing customers as a reward for their loyalty. One supplier argued that there can be a range of benefits associated with offering loyalty tariffs to customers and that these should not be precluded by a measure seeking to prohibit acquisition-only tariffs.

3.15 Finally, a number of stakeholders raised concerns that some suppliers may seek to subvert the intent of this measure, for example by using alternative acquisition channels such as white label providers to offer cheaper tariffs, and by not bringing cheaper offers to the attention of their existing customers. These respondents argued that Ofgem would need to monitor compliance actively.

Updated impact assessment

3.16 We have updated the quantified impacts on suppliers. This builds on the assumption that suppliers would not choose to offer the full extent of cheaper tariffs as a result of this option. However, this is very uncertain and would be subject to suppliers' behaviour and their commercial decisions. Nonetheless, we estimate that potential supplier losses under this option would be £0.9-1.1bn, which is around £0.2bn less than in a 'do nothing' scenario (see Table 1).

Table 1: Quantified domestic supplier losses

		Falling
Do nothing	Total supplier loss (£bn)	1.0-1.3
Option 1	Total supplier loss (£bn)	0.9-1.1

3.17 We have updated our assessment of quantified consumer impacts since we published our consultation. This reflects the updated wholesale prices and supplier information described in Chapter 2. In summary, we still think that this option would reduce tariff differentials between SVT and FTC tariffs compared to the 'do nothing' option. It would reduce the potential savings that active consumers could achieve by switching to another supplier and therefore lead to lower levels of switching between suppliers. It could however lead to increased internal switching, and savings for consumers who may not otherwise have switched.

3.18 We estimate that this option could see active consumers benefit from falling prices by around £2.1-£2.2n. This compares to £2.4bn under 'do nothing'. However, this does not take into account the wider benefits of this option which are difficult to quantify and which could have a significant impact on consumers' longer-term interests. These include consumer trust in the energy market, and access to tariffs that their existing supplier would normally offer only to new customers. Further, it could mitigate costs that consumers would otherwise have to bear if a large supplier exits the market through the Special Administration Regime. These costs could outweigh the benefit that consumers could achieve from falling prices.

Ofgem decision

3.19 **We have decided to proceed with requiring suppliers to make all tariffs available to new and existing customers (option 1)**. Taking into account consultation responses, we consider that implementing this measure on a temporary basis is necessary and proportionate and in consumers' interests as it will help to reduce the risk of unsustainable competition between suppliers. This in turn will help mitigate to some extent against major supplier financial losses leading to significant costs for consumers from disorderly supplier exits and the longer-term negative impacts on investment, innovation and competition.

3.20 We believe that this measure will also help to increase consumer trust in the market, by enabling customers to access their own suppliers' cheapest tariffs. This will be particularly helpful for consumers in vulnerable circumstances, some of whom may struggle to switch suppliers for a range of reasons but stand to benefit from a cheaper tariff from their existing supplier. Rebuilding trust in this way will be important at a time when perceptions of switching risks are likely to be high, particularly among customers that are vulnerable or disengaged, given the unprecedented number of supplier failures we have seen over this winter. This is in line with recent CMA proposals across multiple markets.[6] The FCA has for example recently introduced rules to ensure that renewal quotes for existing insurance customers are not more expensive than they would be for new customers.[7]

3.21 We acknowledge that, if wholesale prices fall, this measure could lead in the short term to suppliers pricing their acquisition tariffs higher than they otherwise would have done. Nevertheless, significant savings will still be available for consumers who do switch and we consider the longer-term benefits to all consumers from implementing this option will outweigh the short-term reduction in available savings to active consumers.

3.22 We also recognise that this measure could have a different impact on individual suppliers based on factors such as their customer mix and hedging positions. And that this could reduce to some extent its effectiveness in stopping major supplier losses in a scenario of sharply falling wholesale prices. To this end, we consider whether additional intervention is warranted to guard against this risk.

Change to licence modification drafting

3.23 We are aware of the practice of 'loyalty tariffs' in the energy market, where some suppliers may offer specific tariffs to their customers to provide competitive rates in reward

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[6] 'Loyalty penalty' super-complaint - GOV.UK (www.gov.uk)
[7] FCA confirms measures to protect customers from the loyalty penalty in home and motor insurance markets | FCA

for their continued loyalty in staying with their supplier. Energy suppliers are not currently obliged to offer these tariffs to new customers. Our policy intent is to prohibit suppliers from offering tariffs that cannot be accessed by existing customers. We recognise that the licence condition as consulted on may impact on other tariffs, such as loyalty or retention tariffs, that do not affect the risks we are concerned about and can otherwise be considered as beneficial to customers.

3.24 In the light of this, we have amended the licence condition to allow Ofgem to grant derogations from this measure for specific tariffs, where we consider that this is in consumers' interests. This is not a substantive policy change and is in line with the policy objective as consulted upon. We consider that the insertion of a derogation clause would effectively provide the Authority with suitable flexibility to account for other unintentional consequences that may arise.

3.25 In applying for a derogation, suppliers will need to make a case to fully justify why they consider the tariff in question should be exempt from this licence condition, taking into account the policy intent. This should include explicit reasons why the tariff in question would provide overall consumer benefit. We will look to process any applications as soon as reasonably practicable.

Next steps

3.26 We will implement this measure on a temporary basis for six months from 14 April 2022 to the end of September 2022, with the ability to extend for up to six months where necessary. Licence Condition 22B will be incorporated into the Electricity Supply Licence and the Gas Supply Licence. We have amended the draft licence conditions[8] to allow the Authority to grant derogations from this measure for specific tariffs, where appropriate.

3.27 Later this year, we will undertake an evaluation of the impact of this measure on consumers and competition. This will help inform future consideration of whether to implement this measure on an enduring basis. We would consult on such a proposal.

3.28 In relation to concerns about suppliers attempting to subvert the intent of this licence condition, we want to be clear that suppliers are ultimately responsible for the tariffs

[8] Final licence conditions can be found in subsidiary documents on our decision page. These have been updated since statutory consultation to provide greater clarity based on stakeholder feedback. https://www.ofgem.gov.uk/publications/decision-short-term-interventions-address-risks-consumers-market-volatility

they offer – whether directly, through white label providers or exclusively through price comparison websites. As such, all those tariffs are covered by and expected to comply with this policy measure. Suppliers will still be able to offer tariffs to specific groups of customers, as long as criteria attributed to the tariff do not distinguish between whether they are new or existing customers.

3.29 Suppliers are already required to tell their customers about their cheapest deals under cheapest tariff messaging rules. This is regardless of the brand that is used to offer the tariff.[9] While this new licence condition is in operation, suppliers will need to include in this messaging all cheaper tariffs they offer or are offered on their behalf by others (e.g., price comparison websites).

3.30 We will monitor supplier behaviour closely and will take the appropriate action where we consider that suppliers are not complying with this obligation.

Option 2 - Allowing suppliers to charge exit fees on certain Standard Variable Tariffs

Proposal

3.31 Under this option, Ofgem would allow suppliers to temporarily introduce exit fees for domestic customers on Standard Variable Tariffs (SVT's) other than deemed contracts.[10] In this way, exit fees would enable suppliers to recover the legitimate hedging costs they have incurred on behalf of their SVT customers, so reducing the potential of major supplier losses – and the associated risks to consumers – in a scenario of significantly falling prices.

Stakeholder responses

3.32 The majority of consultation respondents were opposed to this option. They expressed concerns that exit fees on SVTs would negatively impact consumers and would have a disproportionate impact on low income and vulnerable consumers for whom they would represent a greater barrier to switching. Some stakeholders also felt that this option could negatively affect prepayment meter customers, who may not have experience with

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[9] Suppliers must tell customers if their cheapest deal is marketed under a different brand | Ofgem

[10] "Deemed contracts" arise as a result of statutory provisions and come into existence between a person and a licensed supplier in certain circumstances, where the licensed supplier supplies gas and/or electricity otherwise than in pursuance of a contract (for example, where a person moves into a home already being supplied with energy, or where a supplier of

exit fees, and so could face an unexpected demand for payment and possible debt recovery action.

3.33 Stakeholders raised concerns that exit fees could be difficult, complex or impractical to implement and that exit fees would need to be high to address the risks to suppliers. Some suppliers suggested that the presence of a variable exit fee could affect their ability to provide customers with information to make informed decisions. Suppliers also raised the issue of recoverability of fees, with some suggesting that higher fees would increase the possibility of consumers choosing to not pay the exit fee, so reducing the effectiveness of this measure. Some respondents argued that the option could damage consumer trust and confidence in the retail energy market, as consumers would not normally associate SVTs with exit fees.

3.34 In contrast, a small number of respondents had a more positive view of exit fees. One respondent argued that this was a sensible solution and that, although the fees would be inappropriate for some, it was not necessarily inappropriate for all given the costs suppliers had incurred in purchasing energy for their SVT customers. Additionally, despite not being keen on exit fees as a short-term intervention, some suppliers stated that they were open to having exit fees as a part of a longer-term solution. They stated that altering the price cap so the default tariff is a fixed-term contract with an exit fee could enable the market to be put onto a sustainable footing. They also argued that other issues associated with exit fees could be addressed in a situation where exit fees are common.

Updated impact assessment

3.35 We have updated the quantified impacts on suppliers, which depend on the level of exit fees. We estimate that potential supplier losses under this option would be £0.7-0.9bn, which is £0.4bn less than in a 'do nothing' scenario (see Table 2)

Table 2: Quantified domestic supplier losses

		Falling
Do nothing	Total supplier loss (£bn)	1.0-1.3
Option 2	Total supplier loss (£bn)	0.7-0.9

3.36 Consumers would benefit £1.9-£2.2bn with this option, which is £0.2-0.5bn less than in the Do nothing scenario. Active consumers would still benefit from switching to lower fixed tariffs, although the existence of an exit fee may put some consumers off switching due to the additional cost involved.

Distributional considerations

3.37 Compared to other options, the presence of exit fees could create a stronger disincentive to switching for low-income consumers, for whom the upfront cost could present a barrier to switching.

Ofgem decision

3.38 **We have decided against allowing suppliers to impose exit fees on SVTs at this time (option 2)**. While we consider that this measure would likely be effective in mitigating the risks to consumers we have identified, we recognise the concerns expressed by stakeholders, and believe that other options we have consulted on would be more appropriate and proportionate. However, if other options prove to insufficient or ineffective, then we would consider implementing exit fees if we considered it to be in consumers interests.

Option 3 - Requiring suppliers to pay a Market Stabilisation Charge when acquiring new customers

Proposal

3.39 Under this option, Ofgem would temporarily require all suppliers acquiring a domestic customer to pay a 'Market Stabilisation Charge' (MSC) to the losing supplier. This charge would represent a proportion of the economic loss to the losing supplier for the energy purchased on behalf of their customer.

3.40 The charge would be set such that it would only come into effect if wholesale prices were to fall significantly below the relevant price cap indices[11]. Ofgem would calculate and publish the level of the charge on a regular basis in line with a transparent methodology, enabling suppliers to factor this in when setting their retail tariffs.

Stakeholder responses

3.41 Consultation respondents expressed a mix of views on this option. Larger suppliers were mostly very supportive, with some favouring a higher charge that kicked in sooner rather than later. Respondents noted that this option would have the lowest impact on consumer behaviour and trust. Further this would reduce the risk of unsustainable pricing. Smaller suppliers were more lukewarm and expressed some concerns over deliverability. A

[11] The price paid for the hedges, and therefore the losses incurred when unwinding them change as the wholesale price varies. The trigger is therefore set relative to the weighted average of the relevant price cap indices as described further in the guidance published in support of this decision.

number of other stakeholders felt that the MSC would not be a proportionate response to the risks identified. Consumers groups were generally opposed, due to the potential increase in cost for tariff offerings, which respondents noted may adversely affect competition. Nevertheless, most respondents expressed a preference for this measure over the introduction of exit fees.

3.42 Larger suppliers noted that this charge would help address the volume risks that suppliers are facing, which would lead to more confidence in hedging. They argued that this, in turn, would protect customers under both rising and falling prices scenarios, potentially leading to lower consumer detriment and positive longer-term implications for the market.

3.43 Respondents broadly agreed that we have identified the full range of expected impacts; however, views differed as to the value ascribed to these impacts. Respondents agreed with the view that suppliers would likely factor the MSC into the tariffs that they are offering. Those in favour felt that the MSC would reduce the risk of suppliers sustaining losses on energy that they had bought on behalf of their customers to efficiently limit their exposure in a rising market.

3.44 Those suppliers that recognised the need for intervention generally agreed that the methodology outlined in Appendix 2 of the consultation document would best deliver the charge described in the consultation document. Stakeholders highlighted the need to take account of the fact that suppliers hedge different volumes at different times of year.

3.45 Respondents noted that the effectiveness of this measure depended largely upon the parameters that were indicated in, but not fixed in, the consultation document. Our consultation document indicated that we believed a 30-50% fall in wholesale prices was likely to be an appropriate trigger point with a sharing factor of 50-70%.

3.46 Suppliers expressed a range of preferences for particular sets of parameters in their consultation responses. One larger supplier expressed a strong preference for the charge to apply at all times and to provide complete protection against supplier losses. Another two larger suppliers argued that a trigger of around 20% and sharing factor of 80% were the minimum needed to be effective, with detailed analysis to support their case. In contrast, one larger supplier felt that 50% was the maximum justifiable sharing factor, as suppliers do not hedge for a full 12 months; however the guidance published in support of this decision makes it clear that suppliers are not being covered for 12-month hedging losses.

3.47 When considering the point in time when the charge level should be published, a number of respondents were in favour of the *ex-ante* publication of the charge, with none calling for *ex-post*. Respondents gave a range of views on the appropriate frequency of charge value updates to reflect changes in wholesale prices, from weekly to monthly. The most popular frequency for updates was weekly, as suppliers felt that this would give a charge that reflects expected hedging losses while still being practicable. Respondents did not give strong views on the payment mechanisms that may be used to ensure that charges are collected and paid.

Updated impact assessment

3.48 We estimate that the MSC would reduce the level of supplier losses in our falling prices scenario from £1.0-1.3bn to £0.8-1.2bn (see Table 3). We expect this, in turn, to reduce the prospect of supplier exits (and of the resulting costs to consumers) and improve investor confidence in the retail market.

Table 3: Quantified domestic supplier losses

		Falling price scenario
Do nothing	Total supplier loss (£bn)	1.0 - 1.3
Option 3	Total supplier loss (£bn)	0.8 - 1.2

3.49 We estimate that, with the MSC in place in the falling prices scenario, consumers would still be able to save around £1.8-2.1bn through switching to cheaper tariffs during the six months of the MSC's operation. This compares to £2.4bn under 'do nothing'. The difference between 'do nothing' is because the MSC would reduce the savings from switching and because there would likely be some reduction in switching.

3.50 Any reduction in savings for active consumers needs to be weighed against the benefits for consumers that the MSC could achieve in terms of avoiding significant mutualised costs from disorderly supplier exits. There is a risk of exits from the market by one or more large suppliers, the costs of which would likely be greater than the short term consumer losses from the MSC. The MSC could also help to avoid additional allowances in future price cap updates, and improve levels of investment, innovation and competition in the market.

Distributional considerations

3.51 We still have the same view on distributional impacts as we did at consultation – that the MSC does not require any action by consumers, therefore should not present an additional barrier to switching by low income or otherwise vulnerable consumers. We would expect the MSC to be factored into tariff prices which would reduce savings available to active consumers, it would not affect disengaged consumers, who are more likely to be low income or vulnerable. In contrast, if a supplier were to exit, the socialised costs would be recovered from all customers, including the inactive, low income and vulnerable, so the intervention is likely to make these groups better off.[12]

Ofgem decision

3.52 In the light of the consultation responses and our further analysis, **we have decided to introduce the Market Stabilisation Charge (option 3)** as a temporary, backstop measure – in addition to the requirement for suppliers to make all tariffs available to new and existing customers (option 1).

3.53 We have decided to use the methodology for calculating the MSC broadly as set out in our consultation – see below for details. The mechanism for giving effect to this charge will sit in the Retail Energy Code (REC), as was set out in our consultation.

3.54 We consider that introducing this charge is in line with our statutory principal objective of protecting the interests of future and existing consumers. In combination with the requiring suppliers to make all tariffs available to new and existing customers, the MSC will help suppliers to better manage, on behalf of consumers, the risks posed by severe energy price volatility. In this way, they will mitigate the shorter-term risk of consumers facing significant disruption and additional costs from further disorderly supplier exits (including the failure of one or more larger suppliers), and the associated longer-term negative effects on investment, innovation and competition in the retail energy market.

3.55 The MSC will assist suppliers who have done the right thing by purchasing energy for their customers to better recover those costs if we see a sharp fall in wholesale prices. This is consistent with our duties to have regard to the need to secure that licence holders are able to finance their activities, alongside the need to secure that all reasonable demands for energy are met, and the need to contribute to the achievement of sustainable development, as well to carry out our statutory functions wherever appropriate by promoting effective competition in the market. Importantly, the existence of the MSC should give suppliers greater confidence to hedge more fully for this summer, reducing the risks to consumers in the scenario of rising prices.

[12] Energy consumer archetypes final report.

3.56 We recognise that the MSC is a novel and significant intervention but our analysis demonstrates that it is necessary and proportionate given the volatile conditions in GB and global energy markets, and that there is no other less intrusive measure that will effectively address the scale of the potential risks for consumers. To ensure that the measure is proportionate and minimises the impact on price competition, the MSC will only come into effect where wholesale prices fall significantly below the level used to set the price cap from April 2022. Furthermore, the MSC is a time-limited and targeted measure, which mitigates the risk of unintended consequences for consumers and competition in the market.

3.57 In the event that the charge is triggered, we expect that suppliers will look to pass the MSC onto consumers in the pricing of new acquisition tariffs. This will increase to some degree the price of the cheapest tariffs available to active consumers. Nevertheless, in a scenario where wholesale prices have fallen sharply, there will still be significant savings available to consumers looking to switch.

3.58 As a novel intervention, we will review the impact of the MSC on a monthly basis. If it is not having the effect that we intended, perhaps because there are significant and unexpected market developments, such as material changes in supplier hedging positions or the level of customer switching, then we will consider adjusting the methodology and its key parameters. Before doing so, we commit to consult stakeholders on our proposed changes for 14 days. We will consider any representations that are made during this consultation period before announcing our decision on any necessary amendment. Any changes would come into effect no earlier than when we publish the second weekly update to the charge after the consultation period closes.

3.59 The MSC will be a temporary measure, with the licence condition coming into effect on 14 April 2022 and due to expire on 30 September 2022, unless the Authority decides to extend the condition by up to a further six months to 31 March 2023, or remove it earlier, if we consider that it is necessary to do so. We will assess in July 2022 whether there is a case for extension, and will do so only if we consider it necessary, proportionate and in consumers' interests. We will consult on this in good time before the condition is due to expire. As part of this, we will publish our analysis on whether there is a case to taper down the parameters for the charge in order to smooth the way to removing it altogether.

Key parameters

3.60 Payments under the MSC will only be triggered where wholesale gas and/or electricity prices fall significantly. We have decided to set this **trigger point** at 30% below (i.e., at 70% of) the implied price cap wholesale element for the relevant period (ie summer 2022). This is at the top end of the indicative 30-50% range included in our consultation.

When such a threshold is met, we will publish the charge weekly on a volumetric basis (eg in £/kWh).

3.61 The derating factor determines the percentage of the incremental supplier hedging losses covered by the MSC, while allowing active consumers to continue to benefit from falling prices once the trigger point has been reached and payments are made the MSC. We have decided to set the **derating factor** at 75%. This is at the top end of the indicative 50-75% range that we included in our consultation.

3.62 The trigger point and derating factor work together as a pair to set the strength of the MSC. Our updated modelling, based on newly-available information and updated assumptions, has led to us setting the parameters in this way. To ensure that the MSC is effective in mitigating against risks identified, this requires the charge to take effect sufficiently early and to allow suppliers to recover a sufficient proportion of their losses, but we also wish to leave space for price competition to retain potential gains from switching (alongside non price reasons for switching). As noted earlier, we will continue to review market conditions and the appropriateness of the MSC and will be prepared to change the parameters if necessary.

3.63 To ensure the MSC effectively covers suppliers' efficient hedging losses, losses incurred in unwinding hedges beyond the summer 2022 price cap period are accounted for through the **consumption weighting factor**. While the description of this in Annex 2 to the consultation accurately described this intention, as noted by respondents, we did not correctly account for the fact suppliers do not hedge a full year ahead. We have therefore updated this aspect of the methodology. This change allows the MSC value at a given point in time to more accurately represent the losses incurred by the losing supplier, as it varies according to the volume of gas and/or electricity they are expected to have hedged.

3.64 The MSC is based on an assumed supplier hedging strategy in line with the existing price cap methodology. As such, it will vary as the cost of hedges changes, and will also rise as we approach the winter and suppliers hold larger hedging volumes reflecting higher customer energy demand in the winter. We have published guidance alongside this decision that sets out in full the methodology for calculating the MSC.[13]

[13] Guidance and updated licence drafting for the Market Stabilisation Charge (MSC) can be found in subsidiary documents on our decision page: https://www.ofgem.gov.uk/publications/decision-short-term-interventions-address-risks-consumers-market-volatility

3.65 The parameters that we have set mean that if wholesale prices fall by 30% or less (implying a saving on an average annual dual fuel bill of around £300), customers who switch will be able to access 100% of the potential savings. Beyond this point, the MSC will be 75% of the value of assumed hedges, which as described above, are not for the full year, so consumers signing 12 month tariffs will benefit from more than 25% of the price falls beyond the trigger point.

Table 4 - Illustrative example of cheapest FTC tariff expected under a range of scenarios[14]

	Annualised savings vs summer '22 price cap			MSC level		Savings retained by customer
Wholesale price drop	Without MSC	April price drop w/MSC	September price drop w/MSC	April price drop	September price drop	
30%	£331	£331	£331	£0	£0	100%
40%	£443	£422	£377	£21	£67	85-95%
50%	£547	£493	£418	£54	£129	76-90%
60%	£660	£570	£464	£90	£196	70-86%

3.66 Table 4 illustrates what savings customers could expect to see on a 12 month contract at different levels of wholesale price falls, with a sudden price drop in April or September 2022. Taking the example of wholesale prices falling by 40% below the Summer ’22 price cap, this would – in the absence of the MSC – lead to switching consumers being able to save £443 on an average annual bill relative to the price cap. With the MSC in place, customers would instead be able to save between £377 and £422 (85-95% of the savings they would see without the MSC, depending on when in the summer prices fell, and the switch occurred.

Change to licence modification drafting

3.67 Upon further consideration and in order to improve clarity and transparency we are introducing a few minor drafting changes to condition 24A.1. One clarifies which documents licensees will need to look to for the relevant mechanics of the MSC. This does not change the substance of the obligation as consulted on. This change is to provide clarification that the guidance is not intended to contain separate obligations, rather it is a document

[14] This is an illustrative example of the likely cheapest 1-year Fixed Term Contract an individual customer would see on the market at a particular point in the summer. This is not comparable with our cost benefit analysis (“**CBA**”), as this example considers the individual savings a consumer would make when they switch at a given point in time, whilst the CBA looks at the aggregate savings for the totality of switchers over the course of the 6 months.

containing technical detail that would otherwise be cumbersome in the licence. The change makes it clear that the value of the MSC is determined by the calculation in the guidance and administered in accordance with the requirements of the REC.[15] We have also included the ability for the Authority to withdraw this measure if necessary, for example if significant delivery risks materialise or if market conditions change sufficiently to materially affect the appropriateness of the MSC.

Next steps

3.68 Licence Condition 24A will be incorporated into the Electricity Supply Licence and the Gas Supply Licence.[16] The licence condition will come into effect on 14 April 2022.

3.69 To give effect to the MSC, Ofgem will also raise one (or more) change proposal(s) to the REC to complement and allow for the effective discharge of the new licence obligation on parties to pay the MSC. We expect that the REC change will provide detail of what data will be required to calculate the volumetric element of the charge, how that data will be acquired and the methodology to calculate parties' net positions.

3.70 The Retail Energy Code Company (RECCo) will develop an invoicing and billing mechanism that delivers a value for money solution for suppliers (and ultimately consumers) to give suppliers entitled to payments under the MSC confidence that funds will be transferred in a reasonable timeframe. The billing frequency of the MSC is yet to be determined. While it is possible that some aspects of administrative arrangements for the MSC may not be finalised by 14 April 2022, we nonetheless expect that all suppliers who gain or lose domestic consumers after that date may accrue MSC liabilities or be entitled to payments once the new licence condition takes effect on that date. It is therefore likely that an urgent timetable will be required in order to ensure that the data critical elements of the REC change proposal(s) are given timely effect. Further detail will be set out in detail in the change proposal(s).

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[15] The other changes are to remove a placeholder reference to a specific part of the REC (as the specific part of the REC that will contain the administrative details has not yet been identified) and to update the sub-paragraph numbering to correct an error and fix an internal cross reference. These are all simply minor typographical changes to make corrections, so the condition works as intended.

[16] Licence notice changes can be found in subsidiary documents on our decision page: https://www.ofgem.gov.uk/publications/decision-short-term-interventions-address-risks-consumers-market-volatility

Appendices

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Appendix 1 - Updates to the Impact Assessment methodology and assumptions

This appendix sets out the main method and assumptions we have used in the Impact Assessment. It also provides details of any changes we have made since we published our consultation.

Output	Assumption	Approach
Do nothing		
Supplier impact	Wholesale price scenarios	Falling Prices Scenario Wholesale prices fall to historical seasonal levels for Summer 2022, to c.50p/therm for gas and £52/MWh for electricity. Rising Prices Scenario We have used wholesale price rise to 300p/therm for gas and £309/MWh for electricity.
Supplier impact	Supplier hedging	We have informed our hedging assumptions with monthly supplier hedging positions of monthly SVT customer numbers, from Request For Information, January 2022 submissions. We have uplifted reported monthly supplier hedging positions by 5% (capped to 100%), unless the reported position was at or above 100%. This is to reflect potential increases in hedging as we approach the price cap period.
Supplier impact	Switching rates	Falling Prices Scenario We have updated indicative constraints in the current switching systems with about 150k customer switches per fuel, per week, until July 2022 and have taken into consideration the new switching system arrangements coming in effect in July 2022, to derive monthly switching rates. These have resulted in the following: • SVT customers (long-term disengaged): 15% • SVT customers engaged (who have switched to a small or medium supplier in the past three years): 47% • Customers who have or will come to end of fixed-term tariffs in April 2022: 74% • Customers who have recently gone through the SoLR process: 79%

Supplier impact		Rising Prices Scenario Negligible switching away from SVT is assumed when FTCs are likely to be priced at or above the price cap. We have taken in consideration customers whose fixed tariffs expire over summer 2022, from May-22 and we have assumed they will roll onto SVTs. Based on suppliers' customer number forecasts from Financial RFI as of January 2022, we have taken in consideration the SVT customers that will not be lost over the summer when prices do not fall.
Consumer impact	Consumer saving by switching from SVT to fixed term tariff	Where we have used the level of the wholesale allowance for the Summer 2022 default tariff cap, we have revised the analysis to reflect the wholesale allowance level published on 3 February 2022, as part of the Default tariff cap 01 April 2022 to 30 September 2022. We have weighed consumer benefits using monthly demand. Consumer savings relate to Summer 2022 and Winter 2022-2023 periods: the savings are, respectively, the difference between the level of the default tariff cap in Summer 2022, the default tariff cap in Winter 2022-2023 and the price of cheapest FTC available in Summer 2022.
Consumer impact	SoLR costs	We have estimated the costs consumers will pay through mutualisation of SoLR costs under each of the price scenarios. These costs include credit balances, working capital costs, customer onboarding costs and wholesale costs (for the rising prices scenario only).
Consumer impact	Credit balances	We have used suppliers' credit balances based on individual winter credit balances from September-21 Credit Mutualisation RFI data.
Option 1 – Requiring suppliers to make all tariffs available to new and existing customers		

Supplier impact	Wholesale price scenarios	As per 'Do nothing' option
Supplier impact	Supplier hedging	As per 'Do nothing' option
Supplier impact	Switching rates	<u>Falling Prices Scenario</u> As per 'Do nothing', the revision in weekly switching system constraints has resulted in the following: • SVT customers (long-term disengaged): 13% • SVT customers engaged (who have switched to a small or medium supplier in the three past years): 42% • Customers who have or will come to end of fixed term tariffs in April 2022: 67% • Customers who have recently gone through SoLR process: 72% <u>Rising Prices Scenario</u> As per 'Do nothing' option
Consumer impact	Consumer saving by switching from SVT to fixed term tariff	Similar to the 'Do nothing' option, except we have used historical Summer price differentials between the default tariff cap and cheapest tariff (large suppliers) to inform our view on suppliers' pricing behaviour.
Consumer impact	SoLR costs	As per 'Do nothing' option
Consumer impact	Credit balances	As per 'Do nothing' option
Option 2 – Allowing suppliers to charge exit fees on certain Standard Variable Tariffs		
Supplier impact	Wholesale price scenarios	As per 'Do nothing' option.
Supplier impact	Supplier hedging	As per 'Do nothing' option.
Supplier impact	Switching rates	<u>Falling Prices Scenario</u> Similar to option 1, reflecting different consumer engagement levels up to: • SVT customers (long-term disengaged): 14% • SVT customers engaged (who have switched to a small or medium supplier in the three past years): 45% • Customers who have or will come to end of fixed term tariffs in April 2022: 70%

		• Customers who have recently gone through SoLR process: 75% <u>Rising Prices Scenario</u> As per 'Do nothing' option
Supplier impact	Exit fees	In the main document we have used a hypothetical level of exit fees, around £70 (dual fuel). We have assumed that any fee would need to be (a) proportionate, and (b) must not exceed the direct economic loss to the supplier, as per the consultation document. Therefore, we have assumed that suppliers would be applying exit fees only where they realise economic loss, for customers switching away from SVTs.
Consumer impact	Consumer saving by switching from SVT to fixed term tariff	As per 'Do nothing' option. In the main document we have used a hypothetical level of exit fees, around £70 (dual fuel).
Consumer impact	SoLR costs	As per 'Do nothing' option.
Consumer impact	Credit balanced	As per 'Do nothing' option.
Option 3 – Requiring suppliers to pay a Market Stabilisation Charge when acquiring new customers		
Supplier impact	Wholesale price scenarios	As per 'Do nothing' option

Supplier impact	Supplier hedging	We have informed our hedging assumptions with monthly supplier hedging positions of SVT monthly customer numbers from the Request For Information, January 2022 submissions. For suppliers with a reported hedging position below 100%, we have assumed a higher level of hedging (+10%, capped to 100%), under this option compared to the 'Do nothing'. It reflects an increased incentive to hedge in the presence of the MSC in place, given downside risk has reduced due to the presence of the MSC.
Supplier impact	Switching rates	<u>Falling Prices Scenario</u> Similar to option 1, reflecting different consumer engagement levels up to: • SVT customers (long-term disengaged): 14% • SVT customers engaged (who have switched to a small or medium supplier in the past years): 44% • Customers who have or will have come off fixed term tariffs in April 2022: 70% • Customers who have recently gone through SoLR process: 76% <u>Rising Prices Scenario</u> As per 'Do nothing' option
Consumer impact	Consumer saving by switching from SVT to fixed term tariff	Benefit pre-acquisition is as per "do nothing". It is assumed that the MSC charge will be passed on to customers signing up onto cheaper fixed-term tariffs. Therefore, the benefit for customers switching in Do nothing, is reduced by the amount of the MSC. The total benefit is also reduced by the number of switchers deterred by lower savings available. While the MSC varies with the level of losses incurred by suppliers, the MSC applied in the consumer cost benefit assessment is a monthly average MSC weighted by the effective number of customers switching monthly for each price fall scenario.

Consumer impact	SoLR costs	As per 'Do nothing' option.
Consumer impact	Credit balances	As per 'Do nothing' option.

Methodology

Estimating supplier impact

A1.1 We have estimated the amount per customer that a supplier would lose for any loss-making switching occasion during DTC P8, under each wholesale price scenario. We have updated the methodology since consultation to account for the lost hedges of DTC P9 caused by switching occurring in DTC P8.

A1.2 We have updated the methodology since consultation to adjust supplier benefits/losses under all wholesale price scenarios, by consumption weights from when the switching occurs until the end of the Winter '22/23 period.

A1.3 In falling prices scenario, we have updated the methodology since consultation to use the customer number data from the Customer October 2021 RFI to estimate the number of SVT customers as of April 2022.

A1.4 The switching rates mentioned above then apply on the number of SVT customers as of April 2022 to estimate the number of potential customers that would be willing/able to switch if prices were to fall in or after April 2022.

A1.5 We assume all customers rolling off fixed tariffs between October 2021 and March 2022 would be on an SVT. In both fall profiles, we have assumed customers rolling-off fixed term tariff after April 2022 would roll-off onto another fixed term tariff.

A1.6 Using supplier hedging data provided by RFI, we have estimated the number of loss-making monthly switching customers per supplier.

A1.7 We have assumed a sudden, sharp wholesale price drop in April 2022 as well as a gradual one over the period of summer months. This range is reflected in the cost/benefit tables we present in the main part of the document.

A1.8 Under the MSC, the post-acquisition charge losses are based on the pre-acquisition charge losses to which we remove the monthly weighted average charge throughout the period to the total number of customers switching.

A1.9 In rising prices scenario, we have used hedging data information to estimate the loss/benefit that each supplier would experience, if prices were to rise in or after April 2022. We have assumed a sudden, sharp wholesale price rise in April 2022, as well as a gradual one over the period of summer months. This range is reflected in the tables we present in the main part of the document.

Estimating consumer impact

A1.10 In falling prices, we have estimated the amount that each customer would save if they were to switch from SVT to a cheaper fixed tariff. We have updated the methodology since consultation to adjust consumer benefits/losses under all wholesale price scenarios, by consumption weights from when the switching occurs until the end of the Winter ‘22/23 period.

A1.11 Consumer benefits include SoLR costs mutualised across all domestic consumers, where we have estimated that supplier losses under each of the wholesale price scenarios could result in supplier failure. We assume that any supplier failure caused by a fall in wholesale prices will lead to a mutualisation of its costs across all domestic consumers.

Appendix 2 – Glossary of Terms

MSC	Market Stabilisation Charge
SVT	Standard Variable Tariff
FTC	Fixed Term Contract
SoLR	Supplier of Last Resort
SAR	Special Administration Regime
REC	Retail Energy Code
RECCo	Retail Energy Code Company
CBA	Cost Benefit Analysis
IA	Impact Assessment
PCW	Price Comparison Website