Medium term changes to energy price cap

CAP's official response to Ofgem's consultation

February 2022

always hope.

Summary

Christians Against Poverty (CAP) welcomes the opportunity to speak into a key area affecting many households at this time. With the huge increase in the price cap level from April, as announced in February, thousands of households are likely to be pushed into financial hardship. Reforming how the price cap can be used as a tool to support them is an important step. In its response, CAP would highlight several key areas:

- Continued price protection for consumers is important. Ofgem should recognise the purpose of the price cap is to shield consumers from payment shocks; not as a tool to reduce supplier risk.

- CAP generally agrees that the quarterly update to the price cap option is the most appropriate given current circumstances.

- If this option is implemented, Ofgem should ensure that more information and clarity is made available to all consumers - especially around future forecasting.

- Ofgem may wish to consider separating wholesale costs and operational costs within the scope of the price cap adjustments in future; limiting the frequency by which operational costs can be raised alongside wholesale adjustments.

- There remain concerns on the ability of consumers to afford energy in the long term, especially if prices remain volatile. More should be done beyond the price cap to support them.

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| CAP is authorised and regulated by the Financial Conduct Authority.

Question one: Are there any other costs and risks to consumers and suppliers that we should consider?

CAP agrees with Ofgem that the balance of risk between consumers and suppliers is important, and that this should not swing too far towards either party. Consumers will naturally face risk in all aspects of household finances, and it is right that those with precarious or unstable finances be protected from even further volatility in the marketplace.

The risk of supplier failure is an important consideration, and recent experience has shown the poor customer experience this creates where suppliers fail. It would be a helpful exploration for Ofgem to consider whether there are transferable learnings from the banking sector following their own financial crisis. The Prudential Regulation Authority (PRA) has shown that it is a useful source of experience and support for companies suffering difficulty, and may be as useful to Ofgem in enhancing its regulation of energy firms' captialisation in future.

CAP would like to draw attention to the continued expectation around consumer switching promoted within the sector over recent years. In particular, that switching is generally viewed as the best solution for those seeking cheaper tariffs or a better deal. Recent events have shown that limiting the option for switching to another supplier has meant that the actual support and benefit available to any consumer is extremely limited. As Ofgem is seeking a fair outcome for consumers, it needs to strongly consider whether this expectation of switching and the requirement for consumer engagement adequately creates the fairness it seeks.

Question two: To what extent would a price cap contract without exit fees leave suppliers carrying volume risk in a falling prices scenario? How significant would this be? How might it be mitigated?

This is a difficult question for CAP to be able to answer. As mentioned above, switching appears to remain the only option for consumers trying to seek a better outcome. If this remains the case then it does present greater risks for suppliers when it comes to consumer retention and the risks associated with that. Indeed, given how disengaged the vast majority of the marketplace is, it could be argued that the risk only really comes from the ultra-savvy consumer that is highly active and engaged in the marketplace. CAP would be concerned for consumers that automatically fall onto the price cap tariff without engagement, as any exit fees that might become applicable could limit their ability to find a better deal. Any exit fees considered within this should be nominal and low-risk to the consumer.

CAP would question whether volume risk is the real problem if the price cap is designed well enough to provide true price protection for consumers - as it was intended to do. It is important that the purpose of the price cap remains clear at all stages; providing price protection for consumers rather than covering supplier risk. While it is right that a balance should exist, in practice it is difficult to argue that

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pushing more risk onto consumers - particularly those who are in unstable or vulnerable circumstances - could be considered fair.

Question three: Quarterly updates are a balance between the reduced volume risks and the increased backwardation risks. Please provide evidence and data on the relative costs and benefits of this.

Of the three options presented by Ofgem, this appears to be the most palatable. However, there are considerable factors worth considering within this. In particular, there is an assumption that prices will remain stable in the long term and that consumers can continue to afford their usage regardless of how the price cap changes.

The key benefit that CAP can see from this change would be in smoothing out potential payment shocks a consumer might experience if the changes were less frequent. However, there should be greater consideration given to how these large-impact shocks have evidenced the need for higher-level support from government, such as the one we are currently experiencing. It is important that Ofgem recognise that the sudden changes in the sector have triggered this response, and by reducing the impact of those changes there is a risk that the problems it has highlighted become less apparent.

Additionally, CAP would like to know more about how Ofgem would handle forward forecasting within this proposed system. Given updates would be less frequent, this should mean that future change estimates would be more accurate than they are now. If this is indeed the case, then Ofgem are duty-bound to ensure this forecasting is made clearer and more available to consumers. The insight that provides would give consumers a fairer perspective on their options when it comes to switching and how to manage the long-term changes in energy costs.

Question four: Please provide further evidence on the impact of quarterly updates and price cap contracts on households and their finances, and how these could be mitigated?

The real-world impact of these changes on households and their finances is a subject that CAP can speak very strongly into. The recent upturn in the cost of living has had a major impact on low income households, and many of those that are supported through CAP's Debt Help service face a major change to their standard of living as well as the debt solution that they had been advised to pursue.

Budgeting is not easy for a huge proportion of families, and the ability to plan ahead effectively is incredibly valuable. Increased volatility of prices can make this extremely challenging. Bigger changes in ongoing prices can force major changes, so the more frequent adjustments of the price cap could be a difficult hurdle to overcome. However, if these changes were more predictable then this would help mitigate some of that impact.

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Question five: Do you think it is unfair that consumers could sometimes have higher or lower prices depending on the wholesale cost at the time their cohort starts the price cap contract? Do you think over the longer run this would even out?

It is clear that suppliers have the right to charge the right amount to provide a service to the consumer, so Ofgem's question over whether this is 'fair' or not may not be the correct language to use in this case. CAP would suggest Ofgem's own language around whether the change is clearly *justified*. Does Ofgem agree that it is justified that the cost changes per consumer, and whether that has been made clear enough?

If the cost per consumer is fully dependent on the wholesale cost, then this effectively eliminates consumer choice from the equation. This is not ideal and would likely mean that variable tariffs would make less sense for suppliers to provide. CAP would suggest that the provision of information and consumer education may be a more important consideration in this scenario.

Question six: What opportunity and impact could each proposal have on consumer engagement? Where there may be negative impacts, please provide options and evidence to address these.

As a national debt help provider, CAP would naturally want to gain clarity on the impact these changes would have on those in debt and on future debt collection practices. Ofgem have not mentioned this in the consultation documentation so CAP would prefer to hear additional comments on Ofgem's thinking in this area.

Were there to be more fixed deals on the market (particularly if the fixed contracts were implemented) then this would certainly give consumers greater comfort that their tariff is protected from significant jumps or changes. Clarity is valuable to consumers so this is something that Ofgem needs to put a strong focus on. It is possible that some of the proposals would have a big impact on consumer engagement, and if engagement is limited this also reduces consumer switching. Therefore it is key that as the changes are implemented that the complexity of the marketplace is limited so as to encourage greater clarity and engagement.

Question seven: What other operational impacts could a quarterly update or price cap contract have? Please provide data on the costs and benefits.

CAP would highlight a concern around the continual uplifting of costs that might be possible with the quarterly updates. Each time the cap changes, suppliers will have an opportunity to lobby for adjusted cost-to-serve elements in the price cap. Making changes more frequently does add risk to the consumer of uplifted operational costs as well as wholesale costs. Ofgem should provide reassurance or limitations to how often adjustments are made to operational costs, or alternatively limit the price cap adjustments to purely wholesale cost changes and create a separate policy around the other costs contained within the price cap.

Question eight: Are there any challenges in transitioning to quarterly updates or the strengthened status quo? Please provide details.

CAP does not have enough information to respond to this question. It would merely reiterate the need for clarity of communication, particularly for those in vulnerable circumstances.

Question nine: What would the impact be if suppliers all tried to buy the energy requirements for their customers on price cap contracts in August (for 12 month contracts) or August and February (for 6 month contracts) of each year? Do stakeholders agree there would be liquidity challenges in the wholesale market? How damaging would this be and are there ways to avoid this issue?

No comments provided.

Question ten: If we were to implement the price cap contract, how should we implement it - with an immediate start and a single cohort on a price cap, or with a staggered start and six or twelve different cohorts?

CAP does not have a strong position on this area. However, it is important to recognise that if wholesale costs in winter 2022 are very volatile, then this could create unfairness for those in different cohorts on a staggered programme of transition.

Question eleven: What is a fair and practical way to allocate consumers to different cohorts?

CAP does not have a strong option to propose in this area. However, protecting the most vulnerable must be a priority in any decision made towards this.

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Question twelve: Should we consider any of these variations further? If so, which one(s) and on what basis?

Regarding the question of whether quarterly or tri-annual adjustments could be an option, CAP would want to seek reassurance that the changes limit the impact on consumers. This is especially important if there are material changes to supplier costs; those costs need to be balanced when considering the consumer.

Question thirteen: Do you have any evidence or data that supports or challenges our assessment of the benefits of this? What are the practical considerations for price changes over winter/Christmas?

In CAP's opinion this change generally helps the supplier over the consumer when prices are on an upward trend. Were prices to fall during the winter period, when consumers would benefit the most, then there would actually be benefits to having the adjustments during this period. Therefore, Ofgem would have to make their justification for the balance of risk to both sides very clear if this policy were implemented.

Question fourteen: Do you have any evidence to support a move to a shorter implementation window - such as 14 days? What are the potential risks to consumers of a shorter notice period? What are the operational considerations?

As stated earlier, clarity is important for budgeting over the medium and long term. Shorter-notice changes to household costs are not beneficial to households facing severe financial challenges. CAP would strongly oppose shortening the notice period to this length.

About CAP

CAP is a nationally recognised charity that works across the UK in partnership with 580 local churches to restore hope for people in desperate need. Through a network of almost 300 CAP Debt Centres, CAP offers a free face-to-face debt counselling service, with advice and ongoing support provided from head office. CAP also runs the CAP Money Course, Job Clubs, and Life Skills groups to help people overcome unemployment and provide financial education, all with community and holistic support at their core. CAP's services are completely free and available to all regardless of age, gender, faith or background.

Further information

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