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Dear Cameron and Jeremy

Supplier Licensing Review: reducing credit balance mutualisation

PFP Energy welcomes the opportunity to respond to Ofgem's consultation on the proposed Supplier Licencing changes relating to reducing credit balance mutualisation.

In November 2020, Ofgem made a decision to introduce a range of new ongoing and exit requirements for suppliers operating in the market. The majority of these changes were implemented by suppliers on 22 January 2021, including a new Financial Responsibility Principle. The aims of these measures were to promote more responsible risk management, improve governance and increase accountability, and enhance Ofgem's market oversight and were aligned to principle based regulations. The proposals included cost mutualisation protection: a new principles-based requirement for suppliers to take actions that mitigate the extent of costs to be mutualised in the event of their failure.

We believe that Ofgem has not allowed time to review whether these new and existing protections alleviate what Ofgem perceives as the ongoing risk around credit balance mutualisation. Indeed, in Ofgem's consultation it states that 'However, it may not, by itself, provide complete certainty that suppliers have put in place appropriate protections to prevent the need for cost mutualisation in the event of their failure.' We believe Ofgem will not have been able to evaluate whether the current protections do, or do not provide, the appropriate protections and therefore cannot currently state that the risks perceived in the analysis carried out using 2018/2019 data are still fundamentally true.

All suppliers have been providing Ofgem with data around credit balances as part of Ofgem's ongoing monthly COVID-19 RFI. We were therefore unsure why only historical data, alongside Supplier of Last Resort (SoLR) events that took place in 2018, appear to be being used.

We believe that the more recent SoLR events to take place have not meant that credit balances have been mutualised. Although the chosen SoLR supplier takes into account credit balances, this would be counter-balanced for example by the cost to acquire a customer if the acquisition came via another sales channel. Therefore, we are challenging whether the risk once perceived around credit balances still exists in 2021 to the same level as it may have done in 2018/2019. Coupled with Ofgem's oversight of suppliers through RFIs such as the COVID-19 RFI, Ofgem have the ability to reassess the level of what surplus credit balances may remain and use its existing powers to take appropriate action directly with individual suppliers. In those cases where risk is felt to be high, Ofgem could ask for relevant assurances in-line with current obligations for suppliers to prove they

are not breaching regulations and are acting in-line with regulations including the Financial Responsibility Principles.

There are also further provisions in place to ensure that suppliers are acting responsibly, such as existing Licence Conditions that can significantly negate credit balance risks. For example, licence condition 27.15 requires licensees to take all reasonable steps to ensure that the fixed amount of the regular direct debit payment is based on the best and most current information available. Due to this, many suppliers including PFP Energy undertake regular direct debit reassessments at least every 6 months to ensure that the direct debit amount remains appropriate. Larger providers are also already providing their customers with an automatic refund of any account credit on an annual basis. Existing regulations also require suppliers to refund credit which has accumulated whenever a customer requests it, unless there are reasonable grounds for withholding that credit.

We understand that Ofgem have concerns and of course as a responsible supplier do not wish to incur mutualised costs from suppliers that may act irresponsibly. We can understand Ofgem's intent. However, we feel that there are some fundamental areas within Ofgem's consultation that may need further consideration.

The cost versus benefit does not take into account supplier implementation costs. Therefore a true view of how much the policy costs would be for suppliers to implement these changes has not been reflected in the proposals to-date.

We also feel that when Ofgem published the higher end estimates of refunds due for customers using historical data, this is now what customers expect to be returned.

Ofgem also only appears to be focused on the credit balance element, and not the debt element of the supply business. We agree that customers who pay should not be penalised for those that do not, however debt does have a bearing on these proposals. Debt for suppliers has been growing, particularly due to COVID-19. The unintended consequences on the current proposals could see an increase in the need for suppliers to more rigorously chase those customers in debt.

Ofgem have proposed a 'one size fits all' approach to this perceived credit balance issue, and without allowing for 'exemptions' as there are for many regulations the proposals are in our opinion not manageable. There is no real detail around the Threshold model and how often this may be reviewed. The model has been built using data that is historic. Current practices for autorefunds that exist across larger suppliers have not been reviewed and learnings brought into the proposals. Consumer research has also not been sought, so the overarching assumption is that all customers wish to act in exactly the same way. During the consultation meeting, feedback from two suppliers currently providing customers with an autorefund was that through their own customer engagement there was a strong indication that a significant number of customers valued the ability to hold a balance with their energy supplier to give certainty that they are covered for adverse events (weather or personal).

We feel that the current proposals will take any incentive away for suppliers to offer Fixed Direct Debit products and by allowing customers to receive refunds based on estimates may drive customers to not submit meter readings. It may also lead to customers receiving a refund one day, and then be in debt the next if in fact a meter reading confirms the credit was fictitious. This will

ultimately drive complaints, and supplier cost. Estimated readings and autorefunds should not go hand in hand.

The proposals could also be felt to be more beneficial to some of the larger suppliers, who may already have parent guarantees and Industry Grade credit ratings. The majority of suppliers are not in this position so will ultimately bear the greater impact of these proposals. Surplus credit is also being seen by Ofgem as credit paid by a Direct Debit where a customer starts to pay on the Supply Start Date. In fact, at that point the supplier will already have started to bear different type of costs for that customer. It's also worth noting that this may favour larger suppliers, who are more likely to be able to absorb the negative cash impact from payment in arrears.

Implementation of these proposals is not something that we feel could happen within a few months. Until a final decision has been made, suppliers cannot start to implement changes with 3rd parties such as billing providers and investors. Therefore, from both a system perspective and investment perspective these are likely to take considerable time, at a minimum 6 months from final decision. However, we implore Ofgem to rethink its policy proposals in this area rather than pressing ahead with proposals as they are, even with longer implementation timelines. We also ask Ofgem to be mindful of the already significant programmes being driven for delivery including Quicker Switching, Smart meter roll out and those on the horizon including Half hourly settlements and Microbusiness changes. The resource to deliver all of these policy decisions remains largely with the same teams both within the energy company itself and any required 3rd party resource.

As Ofgem are already aware, the profit being made by supply businesses is negligible, coupled with COVID-19 the 'investment' potential for suppliers to secure additional funding is likely to be hugely expensive or in many cases not possible. We believe the unintended consequences on the current proposals may in themselves lead to unprecedented supplier exits from the market, which in turn creates more risk for cost mutualisation outside of credit balances, for example ROCs.

We believe detailed impact assessments need to be carried out to confirm the true cost of any of these proposals versus the status quo and how in practice some of these may work, using all current data available. The cost and impact of any new reforms will no doubt have a ripple effect onto customers, in particular where customers are owed very small amounts it will likely cost more to provide this back to the customer. Careful thought needs to be given to whether such proposals will meet the aims set out by Ofgem and whether current Ofgem practice can fill any perceived gaps, particularly in light of Ofgem's consultation objectives around mutualisation as cost mutualisation is not currently being seen when recent suppliers have left the market. It therefore appears that recent Ofgem changes may have already ostensibly negated the risk.

The ring-fencing of credit balances without the consideration of debt may also have unintended consequences and careful thought should be given to how estimated meter reads impact these factors. Consideration also needs to be made to the added cost of any changes and how these should be factored into the price cap, the significance of changes in terms of resources and the timelines for change.

Loss making tariffs are also a clear sign of a business operating a higher risk strategy, which in turn makes others do the same to compete. We do not feel that these proposals will stop these practices and that Ofgem already have data and powers to tackle these practices outside of any new reforms.

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Overwhelmingly over 71% of participants in Ofgem's recent stakeholder consultation meeting felt that Ofgem's proposals were not proportionate to deal with credit balance mutualisation. We therefore urge Ofgem to take notice of what we and other suppliers are saying in both the stakeholder meetings and consultation responses.

The energy market is already seeing further contraction and suppliers exiting the market due to financial market volatility. Proposals need to seek to add market stability, not the opposite effect.

Our responses to the specific questions Ofgem set out as part of this consultation follow. Should you require any clarification on any of the points we have made, please do not hesitate to let me know.

Our response is not confidential.

Yours sincerely



Kellie Hather
Head of Regulation & Compliance

Questions

Question 1: Do you agree with our objectives set out in chapter 1?

PFP Energy understand that Ofgem have concerns and of course as a responsible supplier do not wish to incur mutualised costs from suppliers that may act irresponsibly. We can understand Ofgem's intent.

However, we feel that there are some fundamental areas within Ofgem's consultation that need further consideration. We believe detailed impact assessments need to be carried out to confirm the true cost of any of these proposals versus the status quo and how in practice some of these may work, using all current data available. Through these assessments, Ofgem should also determine whether the risk once perceived around credit balances still exists in 2021 to the same level as it may have done previously.

Question 2: Do you agree that our proposals meet our objectives as set out in chapter 1? Please provide views on both our autorefund and threshold proposals and any alternatives you consider that meet our objectives that Ofgem should assess.

PFP Energy feel there is more detail required around the Threshold model and how this may work in practice. For example, how often this may be reviewed. The model has been built using data that is historic, and this may be better overlaid with the more recent data Ofgem have from suppliers.

Current practices for autorefunds that exist across larger suppliers we believe should also be reviewed and learnings from this brought into the proposals. As stated within our wider consultation response, we also believe that existing regulations can significantly negate credit balance risks and therefore would argue that there should be further consideration of these existing measures prior to further requirements being placed onto suppliers.

Question 3: Do you agree that our draft Standard Licence Conditions reflect our policy intent?

PFP Energy agree that the draft supply licence conditions reflect Ofgem's policy intent.

Autorefund:

Question 4: Do you agree that autorefund of credit balances above £0 at the end of 12 months should not be tied to receiving a meter reading from the customer?

PFP Energy do not agree that the autorefund of credit balances should not be tied to receiving a meter reading from the customer, as we believe allowing customers to receive refunds based on estimates may drive customers to not submit meter readings. It may also lead to customers receiving a refund one day, and then be in debt the next if in fact a meter reading confirms the credit was fictitious. This will ultimately drive complaints, and supplier cost.

Threshold:

Question 5: Do you agree that suppliers operating a payment in advance business model should face the cost of the risk they pose to the market?

We believe that suppliers should be responsible and not take undue risks that they themselves do not bear, however many industries operate with a payment in advance model which in itself we do not believe poses significant risk. Across a number of sectors, payment in advance options is an enabler for true competition between organisations of significant differing structures.

Question 6: Do you agree with the obligation and compliance approach for thresholds as outlined?

The threshold model assumes that no significant weather events take place throughout the year. If such an event were to occur (and they are becoming more frequent) then it would likely lead to a debt position that neither the supplier nor customer desired.

A 12 month threshold of zero would lead to many small value refunds which would be disproportionately expensive for suppliers and hold no meaningful value for the customer.

The threshold is set to potentially favour larger suppliers who are more likely able to absorb the cash requirements needed to operate a payment in arrears model.

The threshold assumes a customer desires to have a zero credit balance, although we understand from the consultation meeting that no customer research has taken place (including from suppliers with autorefunds in place) prior to the model being designed. During the consultation meeting, feedback from two suppliers currently providing customers with an autorefund was that through their own customer engagement there was a strong indication that a significant number of customers valued the ability to hold a balance with their energy supplier to give certainty that they are covered for adverse events (weather or personal).

Question 7: Do you agree that there should be tolerances around the threshold and how do you consider these should be set?

PFP Energy agree that there should be tolerances around the threshold, as customer's consumption in any month could vary depending on a number of factors such as the weather or an individual customer's circumstances. Allowing for a certain tolerance level will therefore allow a supplier to hold credit balances slightly greater than the threshold without breaching their licence obligations.

Question 8: For suppliers: For your fixed direct debit customers what is the average percentage difference between estimated annual bills and actual annual bills for those accounts that ended with a positive credit balance?

Within the timescales of this consultation, PFP Energy have not been able to collate the required data to provide an accurate difference between estimated annual bills and actual annual bills for those accounts that ended with a positive credit balance.

Question 9: Please provide your view on the credit balance threshold model published alongside this consultation. Do you agree:

- a. With the methodology we have used to calculate surplus credit balances in our draft threshold model?

PFP Energy believes that taking payment on supply start date as part of the "credit balance" is likely to cause disproportionate cost to suppliers without the backing of a parent company.

- b. That our threshold needs to reflect that consumers who start at different points of the year have different credit balance requirements?

PFP Energy agrees that the threshold needs to reflect that customers will have different credit balance requirements based on their start date in the calendar year.

- c. That our model methodology accounts for the impact of contract start date on our threshold?

PFP Energy agrees in principle that the methodology should take account of the contract start date.

Implementation:

Question 10: Do you agree that these measures should apply only to domestic consumers?

PFP Energy agree that these measures, if implemented, should only apply to domestic consumers. Non-domestic customer credit balances are not mutualised when a supplier fails and arguably, non-domestic customer credit balances are likely to be proportionally lower than domestic credit balances due to how closely customers manage their accounts.

Question 11: Do you agree with the proposed implementation timings?

PFP Energy do not agree with the proposed implementation timings and believe implementation of these proposals is not something that could happen within a few months. Until a final decision has been made, suppliers are unable to begin implementing changes with third parties such as billing providers and investors. Therefore, from both a system perspective and investment perspective these are likely to take considerable time, at a minimum 6 months from final decision.

Question 12: Do you agree with our assessment of the costs and benefits of our proposals as set out in chapter 5 and appendix 1?

PFP Energy feel the cost versus benefit does not take into account all costs, including supplier implementation costs. Therefore a true view of how much the policy costs would be for suppliers to implement these changes has not been reflected in the proposals to-date.

Consideration also needs to be made to the added cost of any changes and how these should be factored into the price cap, the significance of changes in terms of resources and the timelines for change.

Question 13: What implementation costs do you think suppliers will incur should we progress both our autorefund and thresholds proposals? Please detail both the category of cost as well as your estimation of cost figures.

PFP Energy feel that suppliers would incur significant implementation costs if the autorefund and thresholds proposals were to be progressed.

Within the timescales of this consultation, PFP Energy have not been able to fully quantify all costs. However, there would be significant operational and system costs needed to implement the autorefund policy including 3rd party costs.

In addition, for the threshold model we foresee costs relating to system upgrades or manual processing costs to ensure that the value "ring fenced" is accurate on a monthly basis.

Question 14: Do you agree:

- a. We should account for cost of suppliers using parent company guarantees in our assessment of working capital

PFP Energy feel the proposals could be felt to be more beneficial to some of the larger suppliers, who may already have parent guarantees and Industry Grade credit ratings. The majority of suppliers are not in this position so will ultimately bear the greater impact of these proposals.

- b. With our approach to applying the cost of third party guarantees to surplus credit balances

PFP Energy agrees that in principle the concept is fine, however believe it will disproportionately benefit suppliers who are able to seek parent company guarantees.