Strengthening Financial Resilience Investor Relations Call

From: Investor Relations	Date: 04/05/2023 Time: 14:00	Location: Microsoft Teams

1. **Present**

   1.1. **Ofgem**

      1.1.1. Rohan Churm - Director of Financial Resilience and Controls

      1.1.2. David Hall – Deputy Director of Financial Resilience and Controls

      1.1.3. James Doig – Deputy Director, Strategy and Decarbonisation

      1.1.4. Steven Alcorn – Head of Strategic Planning and Investor Relations

0:0:23.790 --> 0:0:27.980
Steven Alcorn
Welcome, everybody. I think we'll just give it another 30 seconds cause a few more people just joining us.

0:0:29.180 --> 0:0:32.60
Steven Alcorn
As I was letting people into the meeting then so just give Me 2 seconds.

0:0:55.980 --> 0:1:25.410
Steven Alcorn
OK, I think it will. We'll start then as more people come along. So welcome everybody to this investor call hosted by Ofgem on the strengthening of financial resilience and a very good morning, good afternoon or evening from wherever you are joining us from. I'm Steven, head of strategic financial planning and investor relations. And what we're going to do today in this session is walk through the decision and the statutory consultations that were announced this morning which will last about 15 minutes and then we'll open to the floor for questions.

0:1:26.290 --> 0:1:47.340
Steven Alcorn
When we open up for Q&A and I will go through the rules, basically you can put your hand up in the usual way if you want to ask question. But if you're dialling in, there's a slightly more complicated, complex procedure, but I'll come to that, so please let me introduce Rohan Churm Ofgem's new director of Financial Resilience controls, who will give an overview of today's announcements. Right over to you.

0:1:48.330 --> 0:2:18.320
Rohan Churm

Thanks, Steve. Hi everyone. It's nice to meet you. And I think it's really important to do these calls and have a two-way dialogue for regulatory developments where they're important for investors. I've joined off Ofgem from the Bank of England where I had significant interactions with market participants in gathering market intelligence, liaising with trading counterparties and indeed in sessions like this talking about regulatory stress testing plans for banks and results. And I hope you value the session as chance to hear directly from the regulator about our plans and opportunity to query and challenge and understand how they will work for our part. We really value the chance to explain what we're doing to directly and welcome informed criticism, particularly when we are consulting.

0:2:33.510 --> 0:3:3.480
Rohan Churm
And when I used to do sessions like this on stress test results for the Bank of England, we started the day with a journalist locking at 5:30 in the morning and tried to explain the nuances of test results to grumpy journalists over coffee and pastries. And that was often with limited success as the headlines came out describing who had failed the test and the scenario of house price Armageddon. And in contrast, questions from the analyst investor community tended to be technically much tougher focused on, you know 81 conversion pre management actions or the data in Appendix C, but much more attention I found was paid for specific answers. So that can be quite refreshing.

0:3:14.880 --> 0:3:27.180
Rohan Churm.
We will welcome feedback from you after today's call as we aim to make these calls work as well as possible. And with that and I'll give an overview of what is announced today before handing over to David.

0:3:30.610 --> 0:3:49.570
Rohan Churm
So Ofgem has today published decisions following a statutory consultation on the enhanced financial responsibility principle and on the renewable obligation being fencing. Those are critical building blocks to our plan to improve financial residents in the sector. The move towards a profitable and sustainably competitive sector.

0:3:50.290 --> 0:3:57.380
Rohan Churm
David is going to take you through the specifics of those and we welcome questions, but I suspect they're not the main focus of today's call.

0:3:58.940 --> 0:4:11.190
Rohan Churm
Instead, there were two areas of the November consultation where we have not moved to decision yet. Instead, we have published our proposals in response to very helpful feedback received and publishing a further short statutory consultation.

0:4:11.920 --> 0:4:19.970
Rohan Churm
That consultation covers our proposals for a common minimum capital requirement and for the power to direct ring fencing of customer credit balances.

0:4:20.890 --> 0:4:23.30
Rohan Churm
And I wanted to make a few headline points.

0:4:23.820 --> 0:4:43.910
Rohan Churm
In terms of the proposals we are now proposing to have a buffer in the common minimum capital regime, with both the target and a floor starting in March 2025, and transition controls such as not paying dividends for those firms with capital levels in between what we're calling in the intermediate position.

0:4:44.950 --> 0:4:52.380
Rohan Churm
That is a bit more complicated than the previous proposal of 1 level as a requirement, but we feel it is beneficial in two ways.

0:4:53.150 --> 0:5:0.380
Rohan Churm
First, it enables a steady state regime where capital can be used to absorb losses in stress alongside a recovery plan.

0:5:1.350 --> 0:5:13.170
Rohan Churm
Second, it creates an effect. A longer transition period for suppliers that needed while accompanying that with controls to protect consumers. Both were suggestions in response to the previous consultation.

0:5:15.150 --> 0:5:26.740
Rohan Churm
The paper also sets out proposals on the definition of capital, the levels of the capital, target and floor, and the supervisory regime around firms falling short of the target. We welcome your feedback.

0:5:27.950 --> 0:5:41.210
Rohan Churm
In terms of the context, I wanted to also recognize that regulatory uncertainty is bad for investment. I hope that the decisions and specific proposals today should significantly increase clarity around the prudential regulatory regime we are creating.

0:5:41.920 --> 0:5:46.480
Rohan Churm
Saying that I'm not going sit here and say that target capital level is now set in stone.

0:5:47.230 --> 0:6:3.160
Rohan Churm
In contrast, the intention is to retain flexibility to adjust the regime in consumers interests, reflecting the risks facing suppliers. That's because we're striking a balance for consumers between the cost of higher capital against reducing the profitability and cost of supplier failure.

0:6:3.950 --> 0:6:15.930
Rohan Churm
With that in mind, if there were reforms to the sector that change the common risks facing

suppliers, we would consult to amend the capital requirements, for example, further price cap reform could reduce the capital target.

0:6:18.0 --> 0:6:28.90
Rohan Churm
We also recognise that these capital requirements will require a profitable and investable sector and we'll be taking that into account with our forthcoming decision on the EBIT allowance in the price CAP.

0:6:29.40 --> 0:6:53.710
Rohan Churm
Today's consultation is open until the 5th of May and we look forward to the feedback we receive. I imagine that will start in about 10 minutes after David has talked you through the slides. While that feedback will hopefully improve our proposals, I can guarantee that we are unwavering in our commitment to prevent excessive and inappropriate risk-taking by energy suppliers, and any would repeat of the excessive cost of supplier failures that we have seen. With that David over to you.

0:6:57.960 --> 0:7:14.390
David Hall
Thanks Rohan. So, I'm David Hall, and I'm deputy director of financial resilience and controls here at Ofgem. So I'm just going give a brief overview of the proposals and the decisions we've taken today and then hopefully leave some time for Q&A afterwards.

0:7:15.230 --> 0:7:22.90
David Hall
And just to say as well, I've also included links in the slides for those keen to check out the details in a in a bit more detail as well.

0:7:23.140 --> 0:7:44.650
David Hall
So I'll start with the decisions and the first of these decisions, as Rob mentioned, is to introduce the enhanced financial responsibility principle. So this enhancement effectively places a positive obligation on energy suppliers to have the capital and liquidity that they need to run their individual businesses.

0:7:45.910 --> 0:7:59.140
David Hall
In doing this, where underpinning a range of the proactive monitoring and reporting requirements that that we conduct on a day-to-day basis and we're more broadly aiming to drive a culture change across.

0:7:59.230 --> 0:8:13.150
David Hall
The way that we work with suppliers to ensure that they're managing their risks in the interests of consumers, so these changes and this new principle in particular will take effect from the 31st of May 2023.

0:8:18.40 --> 0:8:19.50
David Hall
Next slide please.

0:8:20.580 --> 0:8:30.630
David Hall
So the second of the key decisions that we're taking today is to ring fence renewables obligation receipts attributable to domestic supply.

0:8:31.830 --> 0:9:0.840
David Hall
So throughout decision, we've clarified several details about how this ring fencing will work in practice and some of these are listed out on the screen here and the one probably to draw the most attention to is around the timing where we considered at consultation whether we should phase the requirements in or whether we should go ahead straight away from the start of the scheme year. We've taken the decision to bring in the requirements in full.

0:9:0.930 --> 0:9:17.760
David Hall
Beginning in November 2023, covering the Q1 and Q2 of the scheme year. So there will be a sort of natural degree of profiling as the obligations come in through the year, but no explicit phasing beyond that.

0:9:18.720 --> 0:9:40.790
David Hall
Of some of the other details in the slides and in the many documents that we published alongside this, including the decisions we've taken on credit rating for parent companies to be required to have at least triple B minus credit rating and SBLCs and other support to be at a minus or above.

0:9:42.50 --> 0:9:51.20
David Hall
We'll also be monitoring suppliers closely as they approach this November milestone to make sure that there's no particular cliff edge as the requirements come in.

0:9:56.530 --> 0:10:6.910
David Hall
So those are the two decisions. But as Rohan said, we also wanted to focus some time on the elements of the proposals that we're taking to a further consultation today.

0:10:8.530 --> 0:10:34.860
David Hall
So there are three key elements that I want to talk about today and the, as I say, you'll be able to read in more detail in the documents we’ve published, these being the minimum capital framework as Rohan described and the second being how we're defining capital, which is obviously important to that framework. And then the third being the ability that we're taking to ringfence certain supplier credit balances under certain circumstances.

0:10:35.830 --> 0:11:6.180
David Hall
So just starting with this framework. We are proposing to set a capital floor at least zero adjusted net assets per domestic gas and electricity customer by 2025. And then above this floor we're proposing to set a capital target of £130 per domestic dual fuel customer by the same date. So this is a refinement of our original consultation position back in November.

0:11:6.460 --> 0:11:17.130
David Hall
Of a range of 110 to 220 based on the further analysis that we've undertaken at the risk that we believe suppliers face common across the market.

0:11:18.400 --> 0:11:28.210
David Hall
We can just move on to the next slide. Hopefully this illustrates a bit more of what I've been describing and what Rohan was describing at the top of the call as well.

0:11:29.410 --> 0:11:54.120
David Hall
As I say, there are there are two key concepts that we're introducing here are capital floor of zero and a capital target of 130 per customer. So for suppliers below the capital floor, this will be a breach of their licence and so this will mean that we can and likely would take enforcement action as appropriate, for example, imposing provisional orders on suppliers aimed at getting them back into compliance.

0:11:55.300 --> 0:12:25.310
David Hall
Now for suppliers who are above that capital floor, so who have more than zero adjusted net assets, but below the capital target, so they have less than 130 adjusted net assets per dual fuel customer. They will be subject to transition controls aimed at supporting their capitalization to reach that target. So the two transition controls that will apply automatically are a sales ban and a ban on dividends and non-essential payments.

0:12:26.150 --> 0:12:45.70
David Hall
They will also be required to submit a capitalization plan about how they plan to reach the target in due course and may further be subject to other actions such as ringfencing, some or all of their credit balances, which we will come to shortly, and also further monitoring and.

0:12:46.150 --> 0:12:51.270
David Hall
And potentially the requirements to undergo independent audits as well.

0:12:52.160 --> 0:13:0.870
David Hall
And then of course, just to mention as well, suppliers, who meet the capital target will be subject to the usual thorough monitoring and stress testing.

0:13:1.300 --> 0:13:31.960
David Hall
And so underpinning all of this as well, and introduced through the enhanced FRP as I mentioned at the top of the call is an annual adequacy self-assessment that supplier will need to present to us each year and in the first of these annual self-assessments in 2024, we'll be looking to suppliers to demonstrate to us how they intend to meet this new capital target and obviously that will form the.

0:13:32.160 --> 0:13:37.590
David Hall
The basis of how we engage and our expectations in the run up to 2025.

0:13:38.990 --> 0:13:40.490
David Hall
Just go to the next slide please.

0:13:43.120 --> 0:13:45.410
David Hall
So that's how the framework will broadly work.

0:13:46.270 --> 0:13:58.800
David Hall
I just thought it was worth spelling out here. One of the important concepts underpinning these requirements as well, which is of course how we define capital for the purposes of energy regulatory capital requirements.

0:13:59.360 --> 0:14:19.140
David Hall
And so following on from the November consultation, we're proposing an adjusted net assets measure of the minimum capital requirement, which we're aiming to meet the twin objectives of ensuring that companies have loss absorbing capital and that shareholders retain skin in the game.

0:14:20.430 --> 0:14:46.320
David Hall
Now, in the consultation, we've provided much more detail this time around on the types of adjustments that we would deem acceptable and they're spelled out in this slide and also given in greater detail in the proposed consultation and guidance. But in brief, those are unsecured shareholder loans, likewise parent working capital facilities and unconditional corporate guarantees as well.

0:14:52.100 --> 0:14:52.910
David Hall
Our next slide please.

0:14:55.860 --> 0:15:21.370
David Hall
So in addition to the capital requirements, finally we're proposing to take the ability as we proposed in November to ringfence a portion of a specific suppliers customer credit balances under certain circumstances. We've used this consultation to spell out in more detail what we believe to be these correct circumstances and the considerations that we would take when making this decision.

0:15:22.940 --> 0:15:50.510
David Hall
And as you'll see on the slide here, there are there are two key conditions that we're proposing before a supplier could be subject to this ringfencing, the first being that if they're below the capital target that I just described earlier from March 2025 and the second being effectively a liquidity metric to say whether the domestic supply has sufficient cash in the bank to.

0:15:51.550 --> 0:15:54.910
David Hall
To cover 20% of their gross customer credit balances.

0:15:56.50 --> 0:16:10.440
David Hall

And as I say, if either of those conditions are met and we deem it to be in the consumers interests, then we're proposing to have the ability to direct that supplier to ringfence some all of their customer credit balances.

0:16:12.90 --> 0:16:28.160
David Hall
So I think that that wraps up all of the proposals and the decisions that we're taking today and hopefully leave some time for more questions on those details as you'd like. So I think I'll hand back to Rohan or Steve.

0:16:33.960 --> 0:16:47.630
Rohan Churm
We just got one slide on next steps just to clarify that the timelines here. So the two decisions out today become effective at the end of May 23.

0:16:48.690 --> 0:17:19.0
Rohan Churm
And you know the job now for us Ofgem is to you know, deliver the ongoing monitoring and compliance of those but those are essentially imminent. Two that are out further strategy consultation. We are anticipating decisions this summer and then the policies become effective in in the autumn. Clearly just to note that if the common minimum capital requirement is as proposed.

0:17:19.80 --> 0:17:39.740
Rohan Churm
It will become effective in autumn, but as a as a rule, that implies the target and floor coming into place in March 25, so bit of time there, although I think we would expect of course it to affect firm behaviour and planning ahead of that. In fact if not already since this has been coming for a while.

0:17:40.410 --> 0:17:58.490
Rohan Churm
And some firms do already meet our proposed capital target, of course, and. But we do expect to see other firms retaining profit this year and capital raising is of course a possibility, but we'll see. The proposals are not aimed at forcing suppliers into that.

0:17:59.640 --> 0:18:9.770
Rohan Churm
And come 2025, I think you should anticipate seeing the implicit credit rating of GB retail energy suppliers is very significantly improved.

0:18:11.220 --> 0:18:39.790
Rohan Churm
Finally, just to note their the price cap EBIT allowance is anticipated to come out, statutory consultation in May to be effective in the price cap period starting in in the autumn. We welcome continuing to a dialogue and engagement with you throughout that transition with that myself, David and James Doig, our deputy director of Strategy at Ofgem and stand ready to answer your questions.

0:18:43.590 --> 0:19:9.520
Steven Alcorn
Thank you, Rohan, for that. If you do wish to ask questions, please raise your hand. Purely a bit of housekeeping at this point and to let you know that we are recording the call and the transcript will

be available after the call. But of course if you do speak on the call, you'll be on the transcript as well. If you are joining via phone, you'll need to type Star 5, but the instructions are on the screen there.

0:19:9.930 --> 0:19:16.130
Steven Alcorn
I think that we should kick straight off. So I think first question is from Mark Freshney.

0:19:19.940 --> 0:19:21.310
Freshney, Mark (VQYB 1)
Hello. Hello, can you hear me?

0:19:23.240 --> 0:19:24.610
Steven Alcorn
Yes, we can. Thank you, mark.

0:19:24.260 --> 0:19:38.120
Freshney, Mark (VQYB 1)
Hey, thank you for taking my question. I've got two questions. The first one is very much holistic and I think you alluded to you know earlier.

0:19:39.150 --> 0:19:56.820
Freshney, Mark (VQYB 1)
I mean the mark you're looking at one specific area of suppliers. You're not looking at how it would interact with margins. You're not looking at how it interacts with measures such as the market stability charge or the ban on acquisition tariffs.

0:19:59.400 --> 0:20:26.260
Freshney, Mark (VQYB 1)
My question to you is these measures won't have the desired effect and we'll have unintended consequences unless you look at everything together and look at how all the policy interacts, including the government's work and what they might want the market to look like in future. So my first question is how does this fit in holistically rather than just fixing one specific issue?

0:20:27.370 --> 0:20:41.920
Freshney, Mark (VQYB 1)
And secondly, if I were to think about this from a supplier's point of view, suppliers are stuck with customers now, right? There's hardly any switching. They're obliged to supply those customers.

0:20:43.120 --> 0:21:12.850
Freshney, Mark (VQYB 1)
They're not making much margin and now these measures may require them to recapitalize some of those. So in a way you've got some energy suppliers who, if you like a trapped in a sub cost of capital market. So my second question is, I mean, what choice do the companies have rather than just continuing throwing what should be efficient capital into a business where there's no?

0:21:13.310 --> 0:21:16.670
Freshney, Mark (VQYB 1)
No real guarantee they can never get the capital back. Thank you.

0:21:24.720 --> 0:21:27.360
Rohan Churm
Let's take the first one.

0:21:28.670 --> 0:21:34.210
Rohan Churm
First, I think clearly they're somewhat related and so.

0:21:35.570 --> 0:21:37.310
Rohan Churm
Of course in.

0:21:38.720 --> 0:22:5.690
Rohan Churm
In Ofgem we are looking at these issues which are related together. I think I've highlighted the EBIT aspect and the timeline and there is change in the EBIT allowance announced today for the change in the renewables obligation we've made and we're very conscious that.

0:22:6.190 --> 0:22:38.540
Rohan Churm
The price cap is very influential in how these markets work and the risks facing suppliers and I hope I highlighted that you know, if that were changed in in some way then we would be looking to consider the capital levels we've announced today accordingly. So very much agree with you that these things are holistic and need to be thought out collectively. I guess I would push back a bit.

0:22:38.900 --> 0:22:47.500
Rohan Churm
On the idea that that's something that is not happening within Ofgem and on the 2nd.

0:22:48.920 --> 0:22:49.920
Rohan Churm
Of course.

0:22:51.30 --> 0:22:54.840
Rohan Churm
We've seen a number of years where.

0:22:55.490 --> 0:22:55.920
Rohan Churm
You know.

0:22:56.630 --> 0:23:27.460
Rohan Churm
Profits of an average, of course, the industry have not been healthy and people have not been achieving the levels in the price, cap allowances, etcetera. And one of the factors I think behind that and the impact assessment out today has some more colour on this. It was the fact that there was I think pre crisis some unsustainable competition where people were setting prices below the cost of buying energy where they were.

0:23:27.530 --> 0:23:33.310
Rohan Churm

You know, eventually gambling with their customers. Money to do that. And I hope that you know while.

0:23:33.940 --> 0:24:0.460
Rohan Churm
Maintaining a competitive market today, we're aiming for a more sustainably competitive market where you know suppliers are making decisions with at costs in mind that competing on innovation and the cost and price being a way that is much what we are aiming for.

0:24:1.280 --> 0:24:2.280
Rohan Churm
James, do you want to add?

0:24:3.580 --> 0:24:9.70
James Doig
That holistic part of the all that I think I in particular I think you might have seen in the.

0:24:9.830 --> 0:24:40.170
James Doig
Production will be published today. We obviously direct reference to the government announcements last week about exploring the future price protection and I think we are very much working closely with them on that and that will obviously form a factor of where we come to decision on things like the minimum capital requirements at what level we set that given both the government's future direction of the retail market as well as well as our own views about how we want to take forward regulation. I think that you're very right in highlighting there is a clear interlinkage between.

0:24:40.520 --> 0:24:51.580
James Doig
Work we're doing here the EBIT allowance as very obviously tied off as well as you saying the markets stabilisation charge, the acquisition tariffs and all obviously framework. And therefore we do very much.

0:24:52.230 --> 0:25:13.600
James Doig
Recognize the need for that sort of complete view. If you have to make this attractive market for both innovation and investment, and I think hopefully you'll see that coming through more later this year. Obviously this is just one isolated publication here, but we'll keep on trying to draw those linkages for you to make that clear and show how our thinking does fit together.

0:25:18.920 --> 0:25:27.580
Steven Alcorn
Mark, I hope that answers your question. Obviously if you do want to ask another question you can put your hand up and next question is from Martin Young.

0:25:28.380 --> 0:25:29.120
Steven Alcorn
Investec I believe.

0:25:32.540 --> 0:25:33.670
Steven Alcorn
You're on mute.

0:25:39.680 --> 0:25:40.530
Martin Young
Hi, can you hear me?

0:25:41.70 --> 0:25:42.160
Steven Alcorn
Yeah, we can hear.

0:25:41.730 --> 0:26:11.580
Martin Young
Brilliant and afternoon to everybody. I did join the call slightly late, so apologies if I end up asking a question that has already been addressed, but if I look back to what you said and in November you basically said it was your view and proposal that suppliers should be required to hold an amount of capital closely informed by what they are compensated for under the price cap return.

0:26:11.660 --> 0:26:41.760
Martin Young
If you take a price cap of say, you know £2000 per annum if you take that you know 2% margin that would give you £40 per year and at 10% cost of capital for the sake of argument, that's £400 worth of capital on which they are remunerated. Given that you today have outlined 130 pounds.

0:26:41.850 --> 0:26:59.160
Martin Young
By March 2025, is there a plan post March 2025 to see that 130 pound number move upwards to something that is more in line for what suppliers would be remunerated for under the price cap?

0:27:4.110 --> 0:27:24.980
Rohan Churm
Thanks, Martin. Good question. David may want to add on the analysis, but just at a headline level and that is a bit of a change since November in that we've set out this 130 level for the target in the proposal today and we have not said and we think that should.

0:27:26.140 --> 0:27:40.510
Rohan Churm
Necessarily increase and beyond March 2025. In fact we we've highlighted in some ways if the policy and regulatory framework changes as we were just touching on it, it could decrease. So I think.

0:27:40.880 --> 0:27:48.80
Rohan Churm
one of the one of the cross checks that we've got in the stat con the compares.

0:27:48.570 --> 0:28:18.210
Rohan Churm
And some of that capital level at 130 to some of the amounts of capital, we think all suppliers have to hold. I think the key point is that we are setting a common minimum capital requirement in this proposal today and some the notional supplier in the price cap is a fully equity finance supplier that may also meets all its working capital, not just at a loss absorbing risk capital and fixed assets. You know equity capital.

0:28:18.570 --> 0:28:31.480
Rohan Churm

And there are suppliers in the market who achieve those levels of working capital through other means such as market supplier arrangements with other aspects and so.

0:28:31.790 --> 0:28:52.740
Rohan Churm
Certainly what we are saying is that, if there are suppliers that are more risky than the minimum, then they may need to hold more capital than themselves and justify their levels of capital and doing so. But we don't want to impose a sort of common minimum.

0:28:54.30 --> 0:29:6.360
Rohan Churm
That is higher than the common minimum risks that suppliers face. So that's the sort of headline answer. And David, I didn't know if you wanted to add anything on the numbers of material in the doc today.

0:29:8.650 --> 0:29:24.520
David Hall
No, I think that cover most of it actually, Rohan. So if you're keen Martin on, I think it's about page 38 or the of the document as well. There's a, description of how we see it interacting with the price cap as well, which as Rohan explained.

0:29:25.580 --> 0:29:55.410
David Hall
It remains informed by that price cap and consistent but it is a market wide common minimum and so in setting that common minimum we have to allow for the diversity of business models and similarly as Rohan mentioned where suppliers are taking more risks than that common minimum provides for. We will also expect them under the enhanced FRP that we're implementing from today to have the capital in place or risk mitigation.

0:29:55.480 --> 0:29:58.970
David Hall
Measures in place to manage that those additional risks that they're taking.

0:30:4.750 --> 0:30:15.650
Steven Alcorn
Lovely. Thank you very much for that. And next question is from, I think as soon as JENNY PING guest, if you wouldn't mind saying your name and your institution that would be much appreciated.

0:30:16.570 --> 0:30:21.360
JENNY PING
Sorry as Jenny Ping from city, sorry I rushed in to dial in.

0:30:22.840 --> 0:30:45.900
JENNY PING
Just two please, just on the point around the 10banding of zero to 130 as we stand today based on a number of suppliers that we have in the market, how many actually falls within that breach of license or in need of additional equity?

0:30:47.520 --> 0:31:3.780
JENNY PING
If you can give us a sense, you know, without further action as we stand today, how many falls

within that bucket that you know doesn't qualify or below the 1:30 threshold. And also just interested in your

0:31:5.80 --> 0:31:20.730
JENNY PING
Point around sustainable competition. How many players do you actually think is required for the sector to be sustainably competitive?

0:31:24.70 --> 0:31:32.180
JENNY PING
Are you looking to ensure that there is a minimum number of players because obviously there are further consolidation that's happening as we speak. Thanks.

0:31:37.560 --> 0:31:41.120
Rohan Churm
Thanks. Good question. So look.

0:31:41.240 --> 0:31:46.160
Rohan Churm
And it's probably quite hard to say as of today because.

0:31:47.20 --> 0:31:47.930
Rohan Churm
You know we've.

0:31:48.910 --> 0:32:18.140
Rohan Churm
We we've had some developments since suppliers last published sort of accounts and things. But and broadly speaking at a headline level by you know weighted by customers, we think it's around 1/3 of the market is already above the target 1/3 of the market is between the floor and the target. Currently a third of the market is below the target. So that's that, that's the sort of start position.

0:32:18.830 --> 0:32:20.830
Rohan Churm
Because.

0:32:22.170 --> 0:32:53.70
Rohan Churm
Again, I do think we'd anticipate that the market will be profitable this year. Let's wait and see and that's the answer to that that start point. And clearly you know what we hope with today's announcements is that those who are the achieving the capital target can therefore remain there and not go and below it. And that resilience is locked in for the benefit of consumers whereas those.

0:32:53.300 --> 0:33:7.770
Rohan Churm
That need to move up have a bit of time to do so and including the transition controls if they need to go up in be on March 25. On the second question, I'll defer to James its more of a strategic question.

0:33:11.420 --> 0:33:12.350
James Doig
Thanks. Yeah.

0:33:13.240 --> 0:33:29.550
James Doig
Are reflections on your second question, Jenny, it's really around how perhaps the number of suppliers is probably a poor indicator of sort of the kind of competition and the consumer outcomes that we hope to derive from that. I think that where we have seen a market with.

0:33:30.390 --> 0:33:31.900
James Doig
A few dozen.

0:33:32.630 --> 0:33:36.840
James Doig
Suppliers, where they are all running the same playbook where they all.

0:33:37.840 --> 0:33:49.140
James Doig
And offering the same kind of level of service and perhaps where there isn't that, that that shot as a defence, then obviously that perhaps isn't delivering the right track. And so in terms of sustainable competition, we are we're talking about.

0:33:49.790 --> 0:34:14.680
James Doig
Potentially fewer suppliers we've had in the past, but certainly looking to encourage the sort of the diversity of models, the diversity of innovation and that being a driving force going forward. So I suppose we are perhaps less minded to think about sort of the pure numerical terms, I think more around the quality of competition that is delivering those consumer outcomes and.

0:34:16.410 --> 0:34:24.420
James Doig
That's really what you may well see in terms of some of our assessment of that sort of conditions, perfect competition report that we have published in the past.

0:34:26.990 --> 0:34:27.970
JENNY PING
Great. Thank you very much.

0:34:30.950 --> 0:34:48.410
Steven Alcorn
Thank you very much Jenny for that. Just before I go to you, Mark, actually if anybody is joining via the phone and you always put your hand up do type star five if you want to raise your hand and then that way that will enable us to know to come to. But anyway Mark you've got your hand again. So feel free to ask.

0:34:49.520 --> 0:35:18.890
Freshney, Mark (VQYB 1)
Yeah, if I could just follow up, I mean, the numbers you're mentioning are not small. I mean, you mentioned 1/3 of the market being below the target, you know £130 per customer. Having to put that into a business which has not, you know, potentially required capital from you in recent years. I mean, is an unintended consequence of this financial resilience that?

0:35:19.490 --> 0:35:49.700
Freshney, Mark (VQYB 1)

Actually, players walk away from this right. Rather than put these levels of capital in and throw good money after bad is they're not just a risk that that players walk away. And if players are unhappy with this and the capital, they will need to put in, what choices do they have to liquidate businesses? Are they able to just put it into SOLR and walk away and hopefully get some of their capital out?

0:35:49.760 --> 0:35:54.30
Freshney, Mark (VQYB 1)
Or can you? Can you talk us through those options that suppliers might have? Thank you.

0:35:58.630 --> 0:36:3.570
Rohan Churm
And look, I think you know.

0:36:5.590 --> 0:36:16.150
Rohan Churm
Your take on the profitability is sort of at the opposite end to Martins and I think you know, welcome that diversity of views.

0:36:17.230 --> 0:36:35.470
Rohan Churm
I think the major you know problem has been on a back looking basis people you know making losses in in this sector and not necessarily about the levels of return compared to capital. But you know we are highlighting.

0:36:36.100 --> 0:37:6.40
Rohan Churm
That the firms should be compensated in the price cap allowances for the levels of capital, asking them to hold today and you know we are giving a transition timeline, that I think gives people the chance to raise these capital levels over time and should they wish to remain in the industry. And I certainly hope that you know most firms do choose to do so. I cannot though.

0:37:7.450 --> 0:37:27.820
Rohan Churm
Say to you that that that no firms will exit if they don't see the profits as meeting their targets, that is, that is their commercial judgment to make. I'm not sure I've related purely to the capital outcomes announced today. I think you know there's a.

0:37:28.680 --> 0:37:47.850
Rohan Churm
That's a generalized look at the market. Of course, if people want to exit, then there are there of course requirements already in the existing financial responsibility principles about orderly exits and the process that of course we'll we would be in contact with suppliers with and hoping they adhere to.

0:37:54.190 --> 0:37:58.640
Steven Alcorn
Thank you for that, Martin. Yeah, another question.

0:37:58.950 --> 0:38:28.200
Martin Young
I guess it's just carrying on that discussion around the sort of the profitability and I appreciate that you know there is a consultation to come on the EBIT margin, but if you look back at what you had

previously put out, you know in, in that respect, you put an implied amount of capital from the price cap, you know calculations now at a £4000.

0:38:28.390 --> 0:38:58.950
Martin Young
That was quite a significant, you know, number and A you know 1200 pound price cap obviously considerably lower, yeah. Let's just say we're around about the 2000 mark given everything that you have put out to date, you know it would suggest that the implied capital from the price cap calculation is going to be considerably above and you know £130 per dual fuel customer or.

0:38:59.50 --> 0:39:30.0
Martin Young
£65 per single fuel customer depending which way you want to look at it. It is that you know a correct interpretation that it is likely that a that an efficient supplier and is going to add a 2% margin, give or take, you know, earn an amount of money that is commensurate with a higher level of capital than the one that you are implying needs to be held.

0:39:30.390 --> 0:39:47.270
Martin Young
There is effectively now a disconnect between you know this capital requirement which is obviously for balance sheet security and the type of capital on which you would be remunerated for under the price cap. Is that's fair to say.

0:39:49.430 --> 0:39:50.900
Rohan Churm
Well, I think.

0:39:51.980 --> 0:40:17.970
Rohan Churm
It is and it isn't. That's a bit wishy washy but now I think there's some you nuances here so you're right to say that the amount of total capital allowances considered in the price cap formula will be greater than the common minimum capital requirement that we're saying we expect suppliers to hold.

0:40:19.760 --> 0:40:20.710
Rohan Churm
Some.

0:40:21.550 --> 0:40:52.980
Rohan Churm
Some suppliers do things like market access arrangements that reduce the amount of working capital they might need, but of course they might pay fees or other charges for those, so they might pay in a different way and so that needs to be factored in. And as I mentioned, you know for companies that are, you know not doing that. And also if they're taking greater risk, they may need to hold capital on their own standalone basis greater than the common minimum we're saying so.

0:40:53.240 --> 0:41:22.720
Rohan Churm
I think there are some. There are some nuances there. But you know, yes, the common minimum will be less than the total is in that capital they're loss absorbing capital and total capital including working capital can be slightly different concepts. The second point of course is that the sort of EBIT

margin in the price cap is not the only game in town. And let's see what happens to the wholesale prices, but we could well be going back to a market where prices are set.

0:41:23.140 --> 0:41:53.400
Rohan Churm
More competitively and suppliers are coming out with fixed and variable tariffs at the debates that they see they compete on and you know in a way if the market is setting the price isn't people are working out and factoring their cost of capital amount of capital into that then that is sort of more comfortable in a lot of ways for all of us and then a place where Ofgem is setting market price. So hopefully that.

0:41:53.880 --> 0:42:4.130
Rohan Churm
Answers your question, although I appreciate I didn't give a direct yes no, but James did you want to add anything? I know you're supposed to pass on all things EBIT.

0:42:5.290 --> 0:42:18.160
James Doig
Just to underline that point Martin in terms of how obviously you're referring to the capital employed and in fact therefore the risks that are faced by a notional supplier in serving SVT customer.

0:42:19.80 --> 0:42:43.580
James Doig
Worth highlighting various ways for the supplier to take different sort of risk mitigating approaches, but equally in terms of the that sort of customer relationship, you could well take the view that a fixed term tariff customer has a very different risk profile to an SVT customer and therefore it applying this common standard that does apply to every single domestic customer. We obviously have to take.

0:42:45.240 --> 0:43:1.500
James Doig
A slightly more nuanced approach to setting that rather than rather than bluntly applying the average capital employed implied by the price cap for SVT customers. And that's the kind of you may call it disconnect. But that's the kind of analysis that sits behind.

0:43:2.370 --> 0:43:12.660
James Doig
Our current position and again it is a stat con. It isn't something we have gone to decision on. I think we are obviously engaging ourselves as well as.

0:43:13.980 --> 0:43:19.340
James Doig
Suppliers in the market around that. Their views on this and we'll see take that into account in decision.

0:43:23.940 --> 0:43:26.140
Steven Alcorn
Thank you for that. Jenny Ping, your next question.

0:43:27.680 --> 0:43:36.260
JENNY PING

Hi. Thanks again. Sorry two more from me. Just firstly in the context of what's announced today and also the EBIT.

0:43:37.360 --> 0:44:6.150
JENNY PING
A review that's coming up to what extent are you looking at the UK market as a whole compared to some of the European peers and also globally because obviously there is a, you know a cost of capital issue but also a attraction of the market. So if you are looking for that sustainable competitive landscape in it kind of needs to be.

0:44:7.40 --> 0:44:34.240
JENNY PING
Competitive, you know, versus some of the peers and I've done some work recently around some of the European peers and it's just, you know, eye watering in terms of the differential of allowed margins. So I just wondered how much work have you guys done or in in the context of the EBIT margin, specifically around peers and other markets?

0:44:35.460 --> 0:44:48.970
JENNY PING
And then I think the there was a point that made earlier that there is expectations that the market, the retail markets profitable this year. Can I just check do you at what level do you mean?

0:44:50.110 --> 0:44:54.90
JENNY PING
By profitable, or do you mean EBIT or PBT? Thanks.

0:45:0.970 --> 0:45:30.280
James Doig
Let me take the first question, Jenny. So yeah, yes, I mean we are very mindful of perhaps a sort of the global condition of the capital if that's how you want to refer it. And we obviously have been I think sounds like yourself looking at looking at other markets. I think we do also have to be considerate that we have almost unique market design here in terms of the actual risks that our particular supply business face and therefore drawing comparisons with other markets is always difficult in that regard.

0:45:30.360 --> 0:45:51.10
James Doig
But yes, we are conscious that if you are to build that just enable investment market, we do need to make it attractive for the kind of investment that we all obviously need and consumers need in order to reach Net zero. So I think you may see some of that brought out more for you in the stat con for the EBIT consultation.

0:45:53.230 --> 0:45:56.390
Rohan Churm
For that, and I mean on the second question.

0:45:57.950 --> 0:46:5.540
Rohan Churm
I was just giving a sort of general tonal point. You know, based on very early.

0:46:6.760 --> 0:46:11.830
Rohan Churm
Indication some you know the market, what we're seeing and the fact that.

0:46:12.530 --> 0:46:13.220
Rohan Churm
People were.

0:46:14.340 --> 0:46:29.180
Rohan Churm
Better hedged than planned and wholesale prices have come down and so I don't I don't want to put a number on it and today or be in a particular space, but I would anticipate the market being profitable this year as I said.

0:46:30.120 --> 0:46:54.730
James Doig
I would just make one point, as you're all aware, obviously given the way the price cap works, particularly with various deferred allowances. I think obviously some of those in effect have the underlying mechanism of transferring sort of losses from last year into profits this year in terms of some of those extra allowances in place. And therefore, we expect those to be having an effect over the course of this year.

0:46:59.710 --> 0:47:3.20
Steven Alcorn
Alright, thank you very much. Martin Young, back to you.

0:47:5.10 --> 0:47:35.80
Martin Young
Yeah. I guess it's carrying on from, you know, Jenny's sort of overarching questions around profitability. Yes, I get what you're trying to do here about having companies having an appropriately, you know, sized and shaped, you know balance sheet to deal with, you know whatever you know life throws at them, but a lot of people out there are going to care about, you know the profitability.

0:47:35.160 --> 0:48:3.510
Martin Young
And I hear you in respect or you know the timing issues that come through when the price cap allows certain things to be, you know recovered. But if we if we step beyond that and think about a period of time where we are not impacted by timing issues is it fair to say that if?

0:48:3.950 --> 0:48:34.710
Martin Young
We had a market that was dominated by people supplying SVT or similar and we had wholesale prices at current levels, you know, with a historic level of EBIT margin as per the price cap, what 1.9% at the moment. Yeah, should we be thinking around about you £40 to £50 EBIT for?

0:48:34.800 --> 0:48:41.190
Martin Young
And notional supplier is, is that a fair number for people to start with?

0:48:47.670 --> 0:48:54.600
Rohan Churm
Look, I mean, I think I think there's two. There's two parts of the question.

0:48:55.700 --> 0:49:6.140
Rohan Churm
One is what will be announced in in May in the statutory consultation by Ofgem for the for the price cap, and I think you know.

0:49:7.600 --> 0:49:25.110
Rohan Churm
Ofgem isn't releasing material or starting that stat con today, but I think tonally we do recognize the importance of investability and profitability. We've got the temporary allowance for the RO. We recognize that with the risks.

0:49:26.670 --> 0:49:32.170
Rohan Churm
With the market that that those need to be reflected. So I think you know tonally.

0:49:33.350 --> 0:49:45.240
Rohan Churm
That's an indication that's coming across from us today and is even some of the material, but the set against that as I say the.

0:49:46.230 --> 0:50:15.520
Rohan Churm
The price cap and the EBIT allowance may become less relevant to the overall return from suppliers. To the extent that the falling wholesale prices leads to a more sort of standard, dare I say market where suppliers are competing and offering fixed rate and variable products and you know the market will then determine what it will be. So a couple of things potentially in slightly different directions there Martin, but I guess.

0:50:16.650 --> 0:50:16.920
Rohan Churm
Yeah.

0:50:18.360 --> 0:50:20.710
Rohan Churm
You know, I think I think there's a lot of.

0:50:21.530 --> 0:50:39.710
Rohan Churm
There's a lot of water to flow under the bridge before we see what the end profit for companies at the end of this year is. But certainly as I said to Jenny it, it should be, you know it should be positive and you know that should be welcome after the last couple of years.

0:50:40.850 --> 0:50:41.590
Martin Young
OK. Thank you.

0:50:44.460 --> 0:50:54.840
Steven Alcorn

Lovely. Well, thank you so much for that. And I think we're sort of we are a bit out of time actually. So and there's no more hands up. So thanks from me, but I'll hand back to Rohan just to close, but thank you very much for coming.

0:50:56.590 --> 0:51:18.680
Rohan Churm
Yeah. Thanks. Thanks everyone. You know, if you have a further reflections or detailed questions or comments and the material after today do get in, in, in touch you know do feel free to respond to the statutory consultation and we look forward to continuing the two way dialogue and with you being great to meet you today. Thank you.