

Suppliers, consumer groups and  
other interested parties

Date: 2 June 2016

Dear colleagues,

## **The future of retail market regulation**

Following on from our December 2015 consultation,<sup>1</sup> this letter outlines our plans to rely more on principles in the way we regulate the domestic electricity and gas supply markets. The letter also sets out how we intend to adapt the operating model<sup>2</sup> we use to put our rules into practice.

It is essential that everyone is clear about the next steps on this long-term reform programme and how they can engage with us. Therefore this letter outlines a roadmap for reform indicating our key milestones for 2016/17, including when we aim to have removed a significant amount of unnecessary prescription from the supply licence. We plan to discuss how to best maintain momentum for this reform programme at a senior stakeholder event after the summer.

## **Background**

Our December consultation stated our ambition to reform the regulatory framework that applies to the rapidly transforming domestic supply market. Ofgem's role in this transformation is to ensure that we have a more future-proof regulatory framework that enables consumers to benefit from innovation and competition. This framework must also protect consumers from existing and emerging risks in the market and encourage suppliers to put consumer interests at the heart of their businesses.

To fulfil our role effectively, we need to reduce the amount of prescription we use and increase our reliance on principles. If this increased reliance on principles is to result in suppliers taking responsibility for treating consumers fairly, it is vital that we also adapt the way we operate as a regulator. These significant changes to the rulebook<sup>3</sup> and our operating model start with us, and will require us to:

- Where appropriate, shift away from a prescriptive approach to regulation in the supply licence, guidance and other forms of communication with suppliers
- Describe clearly the policy intent of our rules and our expectations of suppliers
- Be comfortable with suppliers delivering positive consumer outcomes in different ways, except where a "one-size-fits-all" approach is needed
- Engage proactively with suppliers and assist with the shift of culture within the industry
- Adopt a more risk-based, structured and proportionate monitoring approach, consistent with our better regulation duties.

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<sup>1</sup> Ofgem (2015) [The future of retail market regulation consultation](#). The responses we received to this consultation, and a summary of the key themes raised in them, will be published on our website.

<sup>2</sup> The "operating model" refers to the regulatory activities we use to put the rulebook into practice. This includes engagement, monitoring, compliance and enforcement activities.

<sup>3</sup> The "rulebook" refers to the standard conditions of the gas and electricity supply licences and the information we issue to help suppliers and other stakeholders understand these conditions. This could include guidance, open letters and other forms of communication.

## Our proposals

Building on the feedback to our consultation and our own analysis, we would like to update stakeholders on the following rulebook and operating model proposals.

### **Rulebook**

- We intend to set out broad principles at the front of the supply licence which focus on a supplier's relationship with consumers. The existing Standards of Conduct (SoC)<sup>4</sup> are a strong starting point in this regard and we will explore modifications that will ensure it remains fit-for-purpose as we remove unnecessary prescriptive rules from the supply licence.
- We will investigate a broad principle which gives prominence to the special regard suppliers should have towards consumers in vulnerable situations.
- We will look at how we can restructure the supply licence around thematic areas, such as those relating to the customer journey.
- We will look at how principles could replace prescriptive rules at each stage of the customer journey. As a priority, we will consider how to reduce our reliance on prescriptive rules relating to tariff design, sales and marketing activities and the information suppliers provide to consumers to help them make informed decisions.
- We will begin to withdraw guidance that is no longer relevant, and ensure remaining guidance fulfils a clear need and is easier to locate.

### **Operating Model**

- We will adopt a risk-based, structured and proportionate approach to monitoring and engaging suppliers. This will build on the activities we currently undertake.
- We will proactively engage with suppliers during the transition to a greater reliance on principles. We will clearly describe the policy intent of our rules and be open to suppliers who wish to discuss how their actions fit with their supply licence obligations.
- We are committed to exploring formal arrangements with the Citizens Advice Service and the Ombudsman Services: Energy to pool intelligence and pick up on risks and issues of concern in a prompt, joined-up way.
- When we observe poor consumer outcomes, and suppliers haven't done all they can to spot and address problems quickly, we will take strong and swift compliance and enforcement action when needed.

Appendix 1 to this letter explains our rationale for these proposals, and addresses other rulebook and operating model issues that were set out in our December consultation.

### **Roadmap for reform**

The table overleaf shows the progress that we propose to make over 2016/17. By end 2016, we intend to have published a Statutory Consultation on principle(s) in line with the Competition and Markets Authority's (CMA) provisional recommendation regarding several of the Retail Market Review (RMR) "simpler choices" rules. This process will join-up with our work to reform the sales and marketing rules in Standard Licence Condition (SLC) 25.

By the end of March 2017, we expect to have finalised our proposal for broad principles at the front of the supply licence and to have key aspects of our operating model in place.

As outlined in the *Budget 2016*, the Department of Energy and Climate Change (DECC) is committed to working with Ofgem to ensure the supply licence conditions are as clear as possible, provide appropriate consumer protections and promote competition. We will continue to work together with DECC to explore how we could shift away from a prescriptive approach in the supply licence conditions that stem from government policy.

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<sup>4</sup> Refers to the customer objective and standards of conduct for supply activities set out in SLC 25C of the [electricity](#) and [gas](#) domestic supply licences.

<b>Date*</b>	<b>Programme Milestone</b>
<b>July 2016</b>	Publish <b>Statutory Consultation</b> on the removal of relevant RMR “simpler choices” rules. Publish <b>Policy Consultations</b> on the introduction of a principle(s) relating to the CMA’s provisional recommendation on the RMR “simpler choices” rules and amendments to the sales and marketing licence conditions.
<b>August 2016</b>	<b>Engage with stakeholders</b> on: <ul style="list-style-type: none"> <li>• Potential broad principles at the front of the supply licence</li> <li>• Ways to restructure the supply licence around thematic areas</li> <li>• How to adapt our operating model to a new regulatory framework.</li> </ul>
<b>September 2016</b>	<b>Senior stakeholder event</b> , which will include consumer groups, to discuss the direction of travel for retail market regulation and to emphasise the need for suppliers to embed principles at the highest level of their organisation.
<b>October 2016</b>	Publish <b>Statutory Consultations</b> on the introduction of a principle(s) relating to the CMA’s provisional recommendation on the RMR “simpler choices” rules and amendments to the sales and marketing licence conditions. Hold a <b>Challenge Panel</b> concerning how suppliers are putting consumers at the heart of their business, particularly in relation to tariff comparability, customer information and sales and marketing issues. <b>Removal of relevant RMR “simpler choices” rules</b>
<b>November 2016</b>	Publish a <b>Policy Consultation</b> on: <ul style="list-style-type: none"> <li>• Broad principles to be included at the front of the supply licence</li> <li>• Ways to restructure the supply licence</li> <li>• Key changes to our operating model.</li> </ul> <b>Propose the next set of prescriptive rules</b> that we intend to review.
<b>January 2017</b>	<b>Go live date</b> for principle(s) relating to the CMA’s provisional recommendation on the RMR “simpler choices” rules and the sales and marketing licence conditions.
<b>March 2017</b>	<b>Statutory consultation</b> on the introduction of broad principles at the front of the supply licence. <b>Start review of the next set of prescriptive rules</b> that could be removed or replaced with principles. <b>Implement key changes to our operating model.</b>

*\*Note that these dates are subject to change.*

## Next steps

We will continue to use the stakeholder feedback we received to our December consultation to develop our thinking on potential principles and how we could adapt our operating model. Stakeholders will also have the opportunity to engage with us over the summer when we ask for feedback on some detailed rulebook and operating model proposals.

If you would like to discuss the initial proposals outlined in this letter, or our general direction of travel, please do not hesitate to get in contact with the team ([FutureRetailRegulation@ofgem.gov.uk](mailto:FutureRetailRegulation@ofgem.gov.uk)).

Yours faithfully,

**Neil Barnes**  
**Associate Partner**  
**Consumers & Competition**

## **The future of retail market regulation – Update on our current proposals and general direction of travel**

The majority of stakeholders supported our general direction of travel and agreed with our proposal to take a phased, priority-driven approach for reforming the rulebook. This will maintain reform momentum, while also allowing us to adapt our operating model in a considered and agile way. This appendix sets out the proposals we will be taking forward over 2016/17.

### **RULEBOOK REFORM**

Our aim is to create a shorter, clearer and more accessible domestic supply licence that shifts away from prescriptive rules, where appropriate, and better utilises broad and narrow principles. We are also committed to reducing prescription in guidance, open letters and other forms of communication with suppliers. This shift in our regulatory approach, and the operating model changes that will complement it, are necessary to promote competition and innovation, while continuing to offer effective consumer protections.

Stakeholders have told us in what circumstances they consider prescriptive rules and broad or narrow principles<sup>5</sup> will be most appropriate. These insights will help us determine where to remove prescription or introduce principles, and how to assess the impact of these changes. Moreover, stakeholders provided views on the role for guidance under our new regulatory approach, and the relationship between principles in the supply licence and consumer protection law. Our latest thinking on some key aspects of rulebook reform is set out below.

#### ***Making clear our expectations of suppliers***

We have decided that broad principles should be given prominence at the front of the supply licence. This will help make sure all energy suppliers, especially new entrants, know how they are expected to behave when participating in the market. At the moment, suppliers are required to navigate a long and complex document in order to understand our overarching expectations. Making broad principles more prominent in the supply licence will also make it easier for consumers, and the groups that represent them, to hold suppliers to account.

Stakeholders have told us they support the objective of “treating customers fairly” that underpins the existing Standards of Conduct (SoC). To ensure that suppliers continue to make strides toward embedding consumer interests at the heart of their business, we are minded to keep the SoC as the core principles of our regulatory regime. Given this key role, we want to remain confident that the SoC allow us to quickly address poor consumer outcomes that arise due to supplier misconduct or incompetence. We are considering whether the SoC need amending in order to remain fit-for-purpose in a regulatory regime that contains fewer prescriptive rules. This includes the formulation of the Standards themselves and the threshold tests within the licence condition. In revising the SoC, our intention would not be to raise existing minimum standards or impose significant new obligations on suppliers.

In our December consultation, we asked stakeholders what other principles could sit alongside the SoC. A strong view shared by the majority of suppliers was that any additional broad principles should be consumer-facing and not seek to prescribe suppliers’ internal operations. They considered that existing supply licence conditions (such as the

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<sup>5</sup> “Broad principles” are high level rules that are sufficiently generic to sit across multiple policy areas. “Narrow principles” are higher-level requirements than prescriptive rules but, unlike broad principles, apply to specific policy areas.

SoC), as well as policy documents such as our Enforcement Guidelines<sup>6</sup> and Financial Penalties and Consumer Redress Policy<sup>7</sup>, already incentivise sound internal processes as they provide us with scope to take supplier shortcomings into consideration.

We are not minded to introduce broad principles relating to suppliers' internal operations. Any new broad principles are likely to focus on a supplier's behaviour towards consumers, and the outcomes that they deliver. We are also mindful that too many principles focussed on internal operations could lead to a compliance culture that does not result in suppliers taking responsibility for putting consumers at the heart of their business. The intelligence gathered from our supplier engagement and monitoring activities will help us to assess whether suppliers are embedding a consumer-centric approach in their businesses.

We will engage stakeholders over the summer on how we might reform the SoC.

This autumn, we will issue a Policy Consultation outlining the new framework of broad principles that we propose to introduce into the supply licence.

### ***Doing more to promote the interests of consumers in vulnerable situations***

Electricity and gas are essential services and consumers who find themselves in vulnerable circumstances have unique needs and interests that suppliers should have regard to. The flexible framework set out in our Consumer Vulnerability Strategy lends itself to a principles-based approach.<sup>8</sup> This framework recognises that vulnerability can be permanent or transitory as people's circumstances change. We see it as the industry's responsibility to be responsive to the needs of these consumers.

We welcome efforts by the industry to date to embrace the Consumer Vulnerability Strategy. This has already increased industry's focus in this area and we note that similar frameworks are being adopted by other sectoral regulators. Nevertheless, we agree with the consumer groups and other industry stakeholders that have said more should be done to give prominence to consumer vulnerability in the supply licence. This will help make sure all suppliers, especially new entrants, are aware of the responsibilities they have for these consumers.

Over the summer we will engage stakeholders on our thinking around a broad principle that clearly communicates our expectations of supplier behaviour towards consumer vulnerability. We envisage this broad principle will also promote flexibility and innovation by enabling suppliers to offer services and products that are tailored to consumers in vulnerable situations. We will consider carefully how to operate this broad principle alongside the existing SoC and other protections relating to vulnerability. We are already considering how we could rely more on principles, rather than prescriptive rules, as part of our proposals to amend the Priority Services Register.<sup>9</sup> We plan to release a Statutory Consultation on these amendments shortly.

Existing prescriptive rules concerning consumer vulnerability will play an important role alongside any new broad principle. These prescriptive rules would only be removed or replaced by additional principles if, after an impact assessment and public consultation process, we were confident that consumer protections would not be weakened.

### ***Priority areas for removing unnecessary prescription and introducing principles***

In our December consultation, we said that we would explore as a priority reforming SLC 25, which relates to sales and marketing for face-to-face selling and telesales. We chose this licence condition because, firstly, we consider there is scope for suppliers to innovate in

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<sup>6</sup> Ofgem (2014) [Enforcement Guidelines](#).

<sup>7</sup> Ofgem (2014) [Statement of policy with respect to Financial Penalties and Consumer Redress](#).

<sup>8</sup> Ofgem (2013) [Consumer Vulnerability Strategy](#).

<sup>9</sup> Ofgem (2015) [Priority Services Register Review – Final Proposals](#).

how they market and sell their products and, secondly, there is already a set of principles in SLC 25 that suppliers must follow.

A majority of stakeholders who responded to our consultation stated that the RMR “simpler choices” rules were prescriptive areas of the supply licence that should be prioritised for reform. The CMA arrived at a similar conclusion in their provisional draft remedies, recommending that Ofgem remove several of the RMR “simpler choices” rules and introduce instead a principle around tariff comparability.

We agree with stakeholders and the CMA that removing these rules is likely to facilitate innovation in the domestic supply market. To enable consumers to benefit as soon as possible we plan to prioritise the removal of the rules identified by the CMA. We have already published an open letter stating that we do not generally envisage that it would be appropriate to take enforcement action in relation to the specific rules mentioned by the CMA in its Provisional Decision.<sup>10</sup> We are also considering further changes we may need to make as a consequence of the CMA’s remedies, particularly to the RMR “clearer information” rules.

The principle recommended by the CMA and potential changes to the sales and marketing rules would both relate to how suppliers support effective consumer engagement and decision making. We will therefore progress modifications to these areas of the supply licence in a joined-up way so that the changes we make are complementary. Consultation on these changes to the supply licence will occur over the summer, with a view to having new principle(s) in place in early 2017.

We will prioritise the introduction of a principle(s) relating to the CMA’s provisional recommendation on the RMR “simpler choices” rules and the amendments to the sales and marketing licence condition.

We aim to consult later this year on the next set of prescriptive rules that we should review in 2017/18.

### ***Making the rulebook more accessible***

Over the summer we will engage with stakeholders on our plan to restructure the supply licence around themes, such as the different stages of the customer journey. Thinking about the supply licence in this way should provide an intuitive framework that helps ensure changes to related licence conditions are made in a coherent manner. Importantly, restructuring the supply licence should also improve its accessibility, thereby making it easier for stakeholders to engage with our rules and understand our expectations of suppliers.

We consider that formal guidance will play a more limited role than at present. We will aim to only give such guidance where it is appropriate to provide additional clarity and to do so in a way that does not unintentionally recreate the prescription we are seeking to remove. Stakeholders told us that they saw value in us using case studies of good or bad supplier practice, similar to the 2014 SoC Challenge Panel report.<sup>11</sup> We agree that this type of guidance could provide lessons on how to embed a consumer-centric approach in a business, rather than prescribe a particular way of doing something.

The significant volume of existing guidance sitting outside the supply licence in different locations (eg decision documents and open letters) can make it difficult for stakeholders, such as new entrants, to find the information they need and understand how it affects them. We are committed to helping stakeholders understand the role of guidance and aim

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<sup>10</sup> Ofgem (2016) [CMA provisional remedies: removal of certain RMR ‘simpler choices’ rules](#).

<sup>11</sup> Ofgem (2015) [Treating customers fairly: Findings from the 2014 Challenge Panel](#).

to improve its accessibility. We will withdraw guidance that is no longer relevant and consider how we could make guidance more accessible on our website.

We will update stakeholders over the summer on our plans to restructure the supply licence around themes and improve the accessibility of guidance. We expect to set out our proposals on these matters in our Policy Consultation in the autumn.

### ***Signposting consumer protection law***

In our December consultation, we asked stakeholders about the relationship between consumer protection law and principles in the supply licence. Most stakeholders held the view that a dedicated licence condition incorporating consumer protection law into the supply licence was not necessary or appropriate. We agree, and do not intend to pursue this option. Nevertheless, better supplier awareness of their broader legal obligations should result in better compliance with similar conditions in the supply licence. We note that where a supplier is, or appears to be, in breach of consumer protection law, this may provide us grounds to consider whether that supplier may also not be fulfilling their obligations under the SoC or other existing rules.

### **OPERATING MODEL**

As we transition to a greater reliance on principles, we need to make sure that the way in which we operate the rulebook supports our objectives of:

- Promoting innovation and competition in the retail market
- Providing effective protections to consumers
- Ensuring suppliers are putting consumer interests at the heart of their businesses.

Achieving these objectives will require us to review our engagement, monitoring, compliance and enforcement activities. Stakeholders have told us that our engagement will need to have a greater focus on describing the policy intent of principles. This will give suppliers the regulatory certainty they need to innovate. Stakeholders also stressed that our monitoring and compliance functions need to be risk-based and proportionate so that suppliers feel empowered to comply with principles in different ways, without facing a greater regulatory burden. If suppliers do not accept their responsibility to put consumer interests at the heart of their business, they will have a more difficult time and, where appropriate, be subject to compliance or enforcement action.

### ***Adopting a more risk-based, structured and proportionate approach***

For our new approach to retail market regulation to be effective, we will need to focus our attention on the suppliers and market issues that pose the biggest risk to consumer interests. We will then need to use monitoring indicators (including qualitative intelligence) that identify issues as soon as possible and allow us to step in so consumer harm can be minimised. We will be engaging soon with stakeholders on the risks we should be looking out for and how we should measure them.

To use our resources effectively and minimise the burden on industry participants, we will need to carry out our engagement and monitoring activities in a proportionate manner. To support this, we are exploring formal intelligence sharing arrangements with the Citizens Advice Service and the Ombudsman Services: Energy that would make sure we are working together, in a streamlined way, to monitor the market and pick up on risks and issues of concern.

Over time, we will be able to reduce our monitoring of suppliers that are able to demonstrate that they have a well-developed consumer-centric approach, have robust risk management processes in place and are engaging openly with us. We are particularly mindful that our intelligence gathering activities, such as requests for information, impose a burden on suppliers. We will seek to ensure that our engagement and information sourcing

is as streamlined as possible, including using the information we already collect as effectively as possible.

### ***Engagement with industry and assisting with a change in culture***

We will adopt a more proactive engagement approach with suppliers and will be seeking to have more open conversations about the policy intent of our rules, while keeping the responsibility firmly with suppliers for thinking about consumer interests. These conversations will also be important for helping us to understand how suppliers run their businesses, including the different methods they may have for complying with principles. We will initiate engagement when we feel there are issues emerging in the market that we need to better understand, such as the innovative business model of a new entrant or new approaches to delivering a service. We will also be more open to engage with suppliers, for instance, when they wish to discuss how new systems, products or services would fit with their obligations.

In addition to a more proactive and open day-to-day engagement approach, we are also keen to establish a structured process for engaging with suppliers who we consider to be posing greater risks to consumer outcomes. In these “assurance meetings”, we would not seek to tell a supplier what to do, but would instead seek assurance that they are embedding a consumer-centric approach in their business. We also see a role for Board-to-Board meetings and Challenge Panels in encouraging all suppliers to put consumer interests at the heart of their businesses.

### ***Enforcing against new principles***

Enforcement will continue to be an important element of our regulatory approach. Where appropriate, in line with our Enforcement Guidelines, we will carry out strong and swift enforcement action against those who do not comply with our rules, whether they are in the form of principles or prescription. As principles are expressed in broader terms than prescriptive rules, some suppliers suggested that our interpretation of them in enforcement decisions should be open to challenge through a merits-based appeal process. We also note the link some stakeholders have made regarding DECC’s consultation on *Strengthening enforcement in the electricity and gas market*.

We consider that the approach we have taken so far to enforcing against the SoC has been appropriate and should be transferrable to other principles. With that said, we accept that it is important for us to describe the policy intent of our principles so suppliers have greater regulatory certainty and feel empowered to innovate. We must also be open to suppliers using different approaches to fulfil their regulatory obligations under principles.

Over the summer, we will engage stakeholders on our approach for developing a risk-based, structured and proportionate operating model. We expect key aspects of our new operating model will be ready to go live by March 2017.