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23 January 2019

Dear Jeremy

### **Supplier Licensing Review**

SSE is a strong supporter of an improved assessment of new entrants' financial stability and welcomes this review. We are very concerned by the current condition of the retail market and believe that urgent action is required to protect the interests of consumers and the stability of the market. The present rate of supplier failure is not only damaging to the perception of the energy market, including customer trust, but also has a material cost to participants and ultimately customers.

SSE supports Ofgem's aim to drive up standards in the sector and minimise customers' and market participants' exposure to financial risk and poor customer service. Supplier failure has consequential impacts across all industry participants including serious financial challenges which are difficult to forecast. As well as uncertainty associated with the ability of counterparties to recover outstanding debt from the defaulting supplier, additional costs are imposed on all solvent suppliers via increased Distribution Use of System (DUoS) charges where the appointed Supplier of Last Resort makes a levy claim. Furthermore, mutualisation of both the Renewables Obligation (RO) (£58.6 million) and Feed-in-Tariff (FITs) (£4.1 million) schemes respectively has created further costs under the price caps and is an additional challenge for all suppliers against a sustainable trading position. Suppliers to the non-domestic market will need to decide how and if they pass through the costs of increased DUoS and mutualisation costs to their customers. The risk of this creating a



contagion effect on other suppliers' financial health should not be underestimated by Ofgem.

SSE has previously advocated for the introduction of supplier 'stress testing' to consider financial adequacy at the time of market entry with additional checks/reviews being undertaken on an ongoing basis. It is SSE's view that only policy Option 3 can deliver Ofgem's policy intent of consumer protection and market stability. SSE does not agree that the additional rigour will create a significant barrier to entering the market and inhibit innovation. The additional requirements are good business practice, are standard requirements in the financial services market and will not deter well prepared participants from entering the market. Energy is an essential service and it is difficult to justify having less stringent requirements in this market than in financial services.

A response to the individual consultation questions is provided in Annex 1. Key points include:

- Ofgem's efforts should address both the initial market entry aspect of the licensing regime and ongoing monitoring to minimise supplier failure and further consumer detriment.
- The consumer protection element is a key aspect of why Ofgem should review its policy. As such, Ofgem should select the most rigorous policy option (Option 3) to minimise detriment to all customers, rather than just those of the supplier that fails. This approach to consumer protection would be consistent with Ofgem's established SoLR credit balance protection.
- This level of rigour is appropriate when compared to the equivalent obligations in FCA regulated companies that do not provide an essential service or have the same requirements to socialise costs.
- Ofgem already seeks a range of information regarding supplier performance and should consider how this could be used to assess the need to intervene and minimise the need to introduce new reporting requirements.

In conclusion, SSE supports the adoption of policy Option 3 which will provide a greater degree of rigour to market entry and would like to see these changes implemented as soon as is possible. We would welcome the opportunity to discuss our response in more detail with Ofgem.

Yours sincerely

Josh Henderson  
**Regulation**

## Annex 1: SSE response

### 1. Do you agree with the principles we have set out to guide our reforms?

Yes. Complying with regulatory obligations, consumer protection and enabling innovation are fundamental aspects of an effective market.

### 2. Do you agree with our proposal to introduce new tougher entry requirements and increase scrutiny of supply licence applicants? Do you agree this can be achieved with increased information requirements and qualitative assessment criteria?

Yes. SSE agrees that there should be tougher entry requirements and increased scrutiny of supply licence applicants. However, SSE does not agree that this can be achieved via policy Option 2. SSE is of the opinion that Option 3 is the only option that will adequately strengthen the regulatory regime to raise standards around financial resilience and customer service whilst providing appropriate balance between protection for customers against financial instability and poor customer service without creating undue barriers to innovation and competition.

The recent increase in supplier failures and the inability of some suppliers to meet their financial commitments to government schemes such as the Renewables Obligation combine to show that now is the time for new entrants to come under increased scrutiny in order to minimise disruption and potential uncertainty for customers. Ofgem states in the consultation that *'energy is a competitive market and it will not operate a 'zero failure' regime'*. Whilst this point is understood, SSE would stress that the current level of supplier failure is unsustainable, unfair on other customers and must be robustly addressed to avoid the risk of compromising the stability of the market and the levels of confidence consumers have in it. The risk of a contagion effect should not be underestimated by Ofgem.

Option 3 offers the advantages of Option 2 plus the additional reassurance that new entrants to the market should be in the position to fund their liabilities appropriately and have the capacity, through stress testing analyses, to withstand adverse market conditions. SSE does not agree that Option 3 will create significant barriers to entering the market and inhibit innovation, as this level of scrutiny is regularly used by the FCA where new entrants must not only demonstrate ongoing financial adequacy but the appropriate infrastructure and control as well. These requirements are needed to demonstrate they are appropriately equipped to operate. Even firms with innovative new technologies or unusual business models are likely to have had to approach investors or apply for funding and or guarantees and would thus have already been challenged as to the efficacy of those models.

Option 3 offers the most robust arrangement in terms of minimising customer exposure to supplier failure at a time where guaranteeing this confidence is needed. These benefits are proportionate to the potential information requirements especially where this can be obtained through existing reporting requirements and Ofgem data monitoring.

**3. Do you agree that our proposed assessment criteria for supply licence applications are appropriate?**

Yes. Having criteria based on resources, understanding regulatory obligations and being 'fit and proper' are appropriate and have equivalence with setting up FCA regulated businesses. The same criteria are used as the basic requirements used for the FCA's Threshold Conditions and 'Fit and Proper' tests. These are designed to set the minimum standards against which the applicant for authorisation will be assessed and are then expected to meet for as long as they are authorised.

Energy supply also involves the cost of supplier failure ultimately being socialised across the wider customer base. This is another reason why assessing new entrants becomes more deserving of having a more stringent assessment as proposed by policy Option 3.

**4. Do you agree that applicants should provide evidence of their ability to fund their activities for the first 12 months, and provide a declaration of adequacy?**

Yes. This is comparable with FCA regulated businesses and in markets where there is less potential for customer disruption and detriment. The approach involves demonstrating the ongoing adequacy of a firm's capital resources being assessed in relation to all the activities of the firm and the risks those activities create.

Ofgem already have a requirement for Network Operators about the availability of resources. Since this covers financial resources and the operational ability to comply with certain licence conditions, there is an opportunity to have a comparable requirement for suppliers too.

With the potential socialisation of the costs relating to supplier failure, customers and other market participants would be best protected through policy Option 3.

**5. Do you agree with the specific information we would generally expect applicants to provide (in Appendix 1)? If not, why/what would you add or change?**

In keeping with the preference for Option 3, new applicants should be required to submit full/enhanced business proposals in order for there to be a fully informed assessment of their market entry. SSE supports the use of stress tests to ensure they can accommodate cost volatility and subsequent capital adequacy.

SSE agrees with the proposed information under the new fit and proper requirements to ensure appropriate accountability within any new supplier.

**6. Do you agree that applicants should provide a narrative in respect of their key customer-related obligations under the licence?**

Yes. A new entrant should be aware of the obligations and have plans in place to meet at least the minimum service standards. SSE welcomes the proposed additional entry requirements where new entrants are required to demonstrate their awareness of key customer service related obligations for the customer base they intend to supply and describe the practical steps they are taking to comply with these. SSE believes these requirements are essential to reduce the risk of customers being exposed to poor quality of service.

**7. Do you agree with the areas we would generally expect applicants to cover (in Appendix 1)? If not, why/what would you add?**

Yes. However, we welcome the opportunity to make further comments once more details are available.

**8. Do you agree that we should ask additional 'fit and proper' questions as part of the application process (as set out in Appendix 1)?**

Yes. However more details on these questions are required to provide a full evaluation. The approach taken by the FCA is an example of where the regulator assesses if the individuals who will manage the business have the right skills and experience to do so without harming consumers or market integrity. The FCA will also look at the connections individuals have with others outside the business, to ensure that the firm is not controlled by individuals who have not been approved. It also considers an individual's history, including but not limited to, an individual's employment and regulatory history and whether they have been involved in misconduct, or any criminal activity or adverse civil proceedings. This approach should be adopted by Ofgem.

**9. Do you agree that Ofgem's licensing process should be undertaken closer to proposed market entry? Do you identify any barriers to this approach or any adverse impacts of this change?**

Yes. Suppliers should be assessed nearer the point of entry and specifically at the point of them being able to take on customers. Ofgem should also be aware of there being knock-on effects in terms of code accession and entry testing processes. Whilst the approach may reduce the numbers of and risk related to dormant or "in entry" licensees, it may result in an increase in the number of speculative code accessions that may sit with market entry certificates for an extended period. We would expect code market entry processes would need to change to time-limit any market entry certification/qualification ahead of grant of licence.

**10. Do you consider that suppliers should report on their financial and operational resilience on an ongoing basis? If so, do you have any initial views on the content of these reports/statements?**

While it is important to ensure suppliers are appropriately equipped at the point of entry, it should also be expected that a supplier's status or stability could change over time.

Ofgem should use reports and information that are already available as indicators of financial and operational resilience, such as:

- Statutory Accounts.
- Severe and rapid reductions in customer numbers.
- Customer service performance measurements; and
- Payments towards social and environmental schemes.

Ofgem should match the approach from the FCA and use authorisation as a forward looking tool to prevent harm by ensuring that businesses can meet their minimum standards at the outset. These includes reviewing culture and the drivers of behaviour that could lead to poor outcomes.

As well as ongoing supervision requiring that businesses can demonstrate that they continue to be sufficiently capitalised, it also focusses on four key drivers of behaviour that can create cultures likely to cause harm:

- The firm's purpose (as it is understood by its employees).
- The attitude, behaviour, skills and capabilities of the firm's leadership.
- The firm's approach to managing and rewarding people (e.g. staff competence and incentives).
- The firm's governance arrangements, controls and key processes (e.g. for whistleblowing or complaint handling).

**11. Do you have any initial views on the potential introduction of targeted or strategic monitoring/requirements on active suppliers?**

Ofgem should analyse and present its findings on the factors involved in recent supplier failures so that monitoring is correctly targeted. A risk-based approach must be appropriately based on previous supplier failures and the indicators available during those times.

**12. Do you have any initial views on the potential introduction of prudential/financial requirements on active suppliers?**

FCA regulated businesses have equivalent requirements of demonstrating ongoing capital adequacy which should be easily adopted by energy suppliers.





**13. Do you consider that Ofgem should introduce an ongoing requirement on suppliers to be 'fit and proper' to hold a licence?**

Yes, this is consistent with the scrutiny around the individuals involved in obtaining the licence and understanding regulatory obligations.

Business leaders have a special role to play because they make important decisions about the firm's strategy and business model, and they oversee the decision making of others. These individuals lead the organisation and shape its culture by setting the tone from the top. For this reason, it is particularly important that they are, and continue to be, fit and proper, that they act with integrity and have appropriate skill.

This ongoing requirement will increase trust across the market. New and legitimate market participants should not be disadvantaged through association with the unsustainable pricing decisions or business management decisions of other new entrants.