

Supplier Licensing Review: Summary of stakeholder responses to November consultation questions on potential ongoing requirements

1.1. This annex accompanies a working paper¹ that updates stakeholders on our thinking for the ongoing requirements and exit arrangements stages of the Supplier Licensing Review.

1.2. We published a consultation in November 2018² setting out policy proposals on new entry requirements and asking for initial views on potential ongoing requirements on suppliers and strengthened exit arrangements. This annex summarises views relating to those questions. We summarised stakeholder views relating to the questions on our 'entry' proposals in our final proposals document published in April.³

Summary of responses

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?

General views

1.3. Respondents were generally supportive of some degree of ongoing reporting on financial and operational resilience. The benefits listed included increased market confidence, an incentive on suppliers to focus on their operational and financial capability and earlier identification and remedy of potential issues. Many emphasised that any reporting needs to be proportionate and efficient.

1.4. Some respondents believed that light touch reporting for all suppliers would not be overly onerous and that a prudent company should be able to provide this type of information without significant effort. Some suggested that any reporting should align with existing obligations and internal financial reporting wherever possible - such as reporting already required by Companies House.

1.5. Other respondents thought that any cyclical reporting should be risk based, or apply to only certain types of suppliers. Views included that reporting should:

- Depend on supplier size. Some felt that smaller suppliers do not pose enough risk for reporting to be proportionate, while others felt the risk was low for large

¹ <https://www.ofgem.gov.uk/publications-and-updates/update-way-forward-ongoing-requirements-and-exit-arrangements-phases-supplier-licensing-review>

² <https://www.ofgem.gov.uk/publications-and-updates/supplier-licensing-review>

³ <https://www.ofgem.gov.uk/publications-and-updates/supplier-licensing-review-final-proposals-entry-requirements>

suppliers and therefore reporting was unnecessary. Some thought that reporting should be required for suppliers growing in size or those who had recently entered the market,

- Focus on the domestic sector, as this is where supplier failures have often occurred,
- Not be required where suppliers' debt is covered by major credit rating agencies – since these institutions already provide sufficiently robust checks on financial resilience,
- Be conditional on risk factors like hedging strategies, below cost tariffs and risk of mutualised costs to the wider market.

1.6. A number of respondents had reservations about financial or operational reporting. Some feared reporting could become overly burdensome for little benefit. Some were sceptical that this type of reporting would reveal suppliers in difficulty, because those suppliers might try to hide the facts and it would be too late to take action once this was realised. Others did not think there were clear benefits in scrutinising companies where Ofgem had no reason to believe they were in difficulty.

1.7. One stakeholder commented that there is a risk that reporting becomes a 'tick box' exercise. It was emphasised by some that there needed to be a clear purpose for the data collected.

Reporting type and content

1.8. Stakeholders had different views on whether certificates of adequacy or viability statements were appropriate. Some viewed these as prudent things for Ofgem to implement to provide robust and consistent assurance both to Ofgem and industry parties.

1.9. There were questions as to how these certificates or statements would differ from a normal 'going concern' statement from an auditor. It was also noted by some that viability statements would be more burdensome than certificates of adequacy.

1.10. Some stakeholders suggested that reporting should be used as a way to track supplier progress against business and growth plans – identifying where suppliers were diverging from their initial plans at entry. Stakeholders suggested a range of ideas for cyclical reporting, including both financial and operational information and metrics.

1.11. Views on frequency of reporting also varied from annual and quarterly – and forecasts included in the report may need to extend beyond 12 months. Some noted that annual reporting would not necessarily pick up issues as financial distress can occur quite quickly. A number of stakeholders highlighted the opportunities of Ofgem working with other parties to gather existing information to develop indicators that suppliers may be failing. It was suggested that monitoring by the Energy Ombudsman and Citizens Advice already identify many issues at an early stage. However, additional reporting could help identify things like maintaining inappropriately high credit balances before customers are adversely affected.

Transparency

1.12. Several stakeholders had views on the level of transparency of any such reporting. Some believed there were benefits in there being some level of visibility on supplier resilience – to provide assurance to service providers and the rest of the market.

However, stakeholders also recognised the potential sensitivities of making information publically available. Other stakeholders thought that there was potential for some information to be publically available, in particular operational data.

1.13. There were calls from some stakeholders for Ofgem to analyse and share its conclusions and learnings from previous supplier failures. Including any provisional findings or lessons learned from closed enforcement cases against failed suppliers.

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

1.14. In many cases there was support for more strategic or targeted monitoring of suppliers as an addition or alternative to market-wide cyclical reporting.

'Milestone' assessment or other trigger points

1.15. Many supported the idea of assessments by Ofgem as a potential consequence of certain 'triggers' being reached. A popular view was that 'milestone' assessments should be associated with customer numbers, in particular customer numbers associated with additional obligations and industry costs (eg 50,000, 250,000). However, it was also recognised that number of customers does not directly equate to the risk the supplier poses.

1.16. Stakeholders suggested a varied range of potential triggers at which point we may want to take further action. One supplier suggested that triggers need to be flexible not static criteria. Suggested triggers for increased information requirements, or assessment, included: offering below cost tariffs, rapid customer growth, customer service problems, change of control, deviation from initial entry plans, being appointed as a SoLR (Supplier of Last Resort) and lack of cooperation with Ofgem.

1.17. One stakeholder agreed with the suggestion that some thresholds should require the appointment of a Compliance Officer – in light of concerns about suppliers growing to significant scale without a sufficient compliance function.

Action when issues are identified

1.18. Some said that having increasingly stringent reporting requirements relative to risk might incentivise suppliers to be more responsible. A respondent commented that monitoring should be designed to encourage companies to proactively flag issues to Ofgem.

1.17 A theme from responses was how Ofgem will manage issues once they have been identified in order to mitigate their likelihood and/or impact. Some respondents commented that the pace of Ofgem enforcement investigations means that this escalation route does not always result in issues being resolved quickly enough to mitigate impacts.

1.18. One stakeholder said they supported Ofgem's approach of working with poor performing suppliers to give them opportunities to improve.

1.19. It was suggested Ofgem should make more use of Provisional Orders or secure voluntary commitments from suppliers to implement improvements. Others suggested measures whereby Ofgem restricts customer acquisitions.

1.20. One stakeholder suggested that Ofgem should be more transparent about the circumstances in which it would be willing to consider licence revocation. One supplier commented that it was unclear if Ofgem could or should take action against suppliers that could cause that supplier to default.

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

1.21. Views on the introduction of prudential or financial requirements were mixed. In answer to this question a number of stakeholders raised suggestions related to credit balances (see below).

1.22. There was some support for potential rules ensuring that suppliers were adequately capitalised and resourced.

1.23. Capital adequacy rules similar to those required by the FCA were mentioned as a potential option for energy suppliers. One respondent noted that suppliers should have financing arrangements in place to meet certain scenarios that could place additional costs on suppliers – such as extreme winters and increased commodity prices. Two suppliers recognised potential in having financial requirements that were imposed/adjusted based on supplier risk.

1.24. As well as capital adequacy rules, a stakeholder suggested Ofgem could also consider the FCA's requirements related to cultures and behaviours where bad practice could lead to poor outcomes.

1.25. A couple of stakeholders suggested it may be appropriate to increase oversight of supplier pricing – for example, suppliers demonstrating they have the contracts, instruments and arrangements to deliver the volumes and prices they have committed to.

1.26. Some recognised that financial or prudential requirements risk inhibiting innovation, saying it would be challenging to develop rules that are suitable and fair for all potential business models. A number of respondents felt that financial/prudential requirements would not be necessary if the costs of failure (specifically costs at risk of mutualisation) are born by the failing supplier.

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

General views

1.27. Of those that responded to this question, the majority supported the idea of an ongoing fit and proper requirement in principle. A number of stakeholders stated that if a fit and proper test is applied at entry, then it seems logical for this requirement to continue in some form on an ongoing basis. Reasons given for supporting a fit and proper requirement in the licence conditions included that it would encourage suppliers

to take their obligations seriously, increase trust in the market, and discourage activities that may cause harm to consumers and/or industry.

1.28. Some respondents said that is important for individuals in senior or influential positions to be 'fit and proper'. Others viewed this requirement as an opportunity to ensure the supplier as a whole is suitable and/or capable to deliver acceptable service standards and comply with obligations. One respondent thought that a fit and proper requirement would be particularly important if Ofgem wishes to encourage innovative or untested business models.

1.29. However, some stakeholders had reservations; one asked for further clarity as to the problem that has been identified. One stakeholder suggested Ofgem should be wary about implying a positive endorsement of a supplier. They also argued that the combination of other potential management and financial test options should demonstrate whether a company is of sufficient quality to be a credible market competitor.

Assessment of suitability

1.30. One stakeholder suggested suppliers should provide regular assurance of their position as 'fit and proper', another suggested that provision of information should be risk-based, so not to put disproportionate burdens on suppliers who have displayed no cause for concern.

1.31. Some stakeholders envisioned that a fit and proper reassessment could be undertaken following changes of circumstances – a change in control or director for example. A supplier suggested the ideal solution would be for Ofgem to have powers to veto a change of control or appointment of persons it deems unfit, rather than risking market or customer detriment.

1.32. One supplier felt it was more proportionate for Ofgem to only investigate if information came to its attention that suggests the licensee may no longer satisfy the fit and proper requirement – rather than requiring proactive confirmation from all suppliers.

1.33. Some stakeholders commented on interactions between an ongoing fit and proper test and the director disqualification regime. One questioned how it would work alongside and enhance the existing requirements, while another asked how proposals would go beyond what is already required by the Companies Act. One supplier commented that if Ofgem wanted to seek to remove directors under a fit and proper requirement the level of unsuitability would have to be very significant and unambiguous.

1.34. Some stakeholders thought that there would need to be timely and effective sanctions under a fit and proper requirement.

1.35. A stakeholder stated that great care would need to be taken over what is published in relation to fit and proper requirements. This is because if there is a risk of a company losing their licence, or Ofgem declares the business unsustainable, this could affect investor funding.

Credit balances and exit arrangements

1.36. There were no specific questions on credit balances or exit arrangements in our November consultation, however, we have summarised key themes from stakeholder comments on these matters.

Credit balances

1.37. There was wide support for considering the introduction of new credit balance rules. A number of stakeholders commented that material policy changes in this area would likely need an implementation period.

1.38. It was noted by one stakeholder that while it is inappropriate for suppliers to rely on credit balances to operate, it is normal to expect build-up of credit balances at certain times of the year. One respondent commented that new entry requirements and effective ongoing monitoring would reduce unplanned supplier exits and risks of credit balance mutualisation. Another argued that the level of credit balances market wide could increase over time as consumption habits change, like increased electric vehicle usage.

1.39. Specific suggestions from respondents are categorised below:

<i>Tariff restrictions</i>	<p>A number of respondents voiced concerns about irresponsible use of advanced payments for energy. In particular, where there are large upfront payments. One response argued that this is leading to customers who can afford upfront large sums getting cheaper deals, potentially with interest, while the risk (of mutualisation) falls to consumers who cannot afford these tariffs.</p> <p>Some suggested Ofgem should restrict the ability for suppliers to offer these types of tariffs. Others thought that additional regulations should apply for these types of tariffs. For example, the supplier must be able to demonstrate it can cover the costs of credit balances. One supplier suggested the rules for these types of tariffs should be akin to FCA rules on financial products.</p> <p>Some respondents thought it was reasonable for suppliers to offer incentives to customers to retain modest credit balances.</p>
<i>Accurate payments</i>	<p>More accurate payments could reduce credit balance build up. Options mooted were:</p> <ul style="list-style-type: none">• Mandate billing in arrears,• Requiring variable direct debit payments,• Requiring review of a customer's account at a defined frequency
<i>Caps on credit balances and/or credit balance protections</i>	<p>There was some support for the idea of capping the level of credit balances suppliers can hold on a per customer basis.</p> <p>There was recognition this would need to be at an appropriate level that accounted for seasonality and consumption patterns. It was also noted that caps could create challenges by restricting the ability for suppliers to smooth costs over the year, increasing hassle and risk of debt for customers. One suggestion was that each customer's credit balance could be restricted to their annual consumption level.</p>

	<p>Some suppliers argued that a per customer cap could be complex to administer.</p> <p>Another option suggested was that the credit balance 'safety net' under the SoLR process could only extend to a certain level per customer – provided customers were given clear information and opportunities to prevent their credit balances becoming at risk.</p>
<i>Restrictions in how credit balances are used</i>	<p>Some respondents were of the view that it may be necessary to restrict the ability for suppliers to use credit balances as working capital. Restrictions could include ring-fenced funds.</p> <p>One supplier's view was that a separate account for credit balances could be onerous. Another suggested just a proportion of net credit balances should be ring-fenced. One respondent said ring-fencing risked additional costs to maintain funding and divert funding away from innovation.</p>
<i>Guarantees on credit balances</i>	<p>There was support, as a preferable alternative to the above measures, for suppliers to provide some form of surety. For example, a parental guarantee, a letter of credit or money in escrow so that costs are not mutualised in the event of failure.</p> <p>Many suggested this type of measure should allow some degree of flexibility for the supplier in how they achieve appropriate surety.</p> <p>There were differing views as to whether it is proportionate for these types of measures to prevent all mutualisation of credit balances, or whether it should just extend to a proportion of costs. One supplier said that the level of cover required must be set out in an unambiguous and enforceable way.</p>

1.40. Some respondents thought that credit balance rules should be imposed based on the risk posed the supplier – with increasing scrutiny and control by Ofgem.

1.41. One respondent raised the idea that credit balance protections should be extended to microbusinesses.

Other mutualised costs

1.42. The majority of respondents commented that credit balances are often not the only costs associated with supplier failure. Non-payment of government schemes, the Renewables Obligations (RO) in particular, were the most commonly cited costs.

1.43. Some stakeholders took the view that there should be additional obligations on suppliers to bear an appropriate share of these costs too. This included:

- Credit cover, performance bonds, self-insurance or other security arrangements,
- Requirements for suppliers to have sufficient financial provisions to pay costs.

1.44. Other stakeholders suggested a more holistic approach, with an overarching obligation on suppliers to prevent or mitigate mutualisation of any costs in the event of failure. Suppliers would be required to demonstrate to Ofgem how they are complying with this obligation.

Suggestions for exit arrangements included:

- Review of the SoLR process – including the credit balance safety net, treatment of customer debt and the weighting of criteria during the competition process.
- A suggestion there could be consolidated industry wide credit cover arrangements to provide cover in the event of supplier failure, or an industry wide cost recovery mechanism – like a ‘pot’ or insurance scheme – to cover costs associated with supplier failure and/or SoLRs.
- Considering reviewing processes and protections for affected third party services, like the Energy Ombudsman, shipping and metering.