

Supplier Guaranteed Standards of Performance for Switching: Update to November 2018 Impact Assessment

Division:	Retail System Transformation	Type of measure:	Retail Competition measures
Team:	Switching Programme	Type of IA:	Not Qualified under Section 5A UA 2000
Associated documents:	Supplier Guaranteed Standards of Performance: Approach to Impact Assessment on Introducing Switching Compensation Supplier Guaranteed Standards of Performance: Impact Assessment	Contact for enquiries:	SwitchingCompensation@Ofgem.gov.uk

Summary

In June 2018 we consulted upon new supplier Guaranteed Standards of Performance relating to switching. These measures will introduce automatic compensation for consumers when switches go wrong, provide recompense for detriment incurred and improve incentives to ensure suppliers improve their switching performance.

Alongside our June consultation we published an Approach to Impact Assessment document, containing our rationale for intervention and an assessment of the options that we considered. We produced a fuller analysis of the estimated costs and benefits of our proposals, based on responses to our Request for Information (RfI), alongside our November decision document.

This document provides an update on that Impact Assessment, based on revisions to the proposed Guaranteed Standards that we are now consulting upon.

1. Revised analysis of costs and benefits

Section summary

In this section we build on the approach as set out in our Approach to Impact Assessment and Impact Assessment documents, in order to assess the impacts on costs and benefits of our revised proposals for Guaranteed Standards.

Purpose of this Impact Assessment

1.1. We have previously published an Impact Assessment for our proposed Guaranteed Standards alongside our November decision document, and an Approach to Impact Assessment document setting out our approach to calculating the costs and benefits of our proposed Guaranteed Standards alongside our June consultation.

1.2. The case for intervention and our methodology for assessment is set out in Chapter One of our Approach to Impact Assessment document and we have not reproduced it here.¹ In our Impact Assessment document, we carried out a fuller analysis of costs and benefits, which we have also not reproduced in full.²

1.3. The purpose of this document is to explain the changes to this analysis arising from our revised proposals for three Guaranteed Standards which we intend to implement via the Statutory Instrument associated with this document.

Changes to calculation of estimated benefits of the proposed Guaranteed Standards

1.4. As explained in our previous Impact Assessment documents, we elected to use a static model of the direct costs and benefits of the introduction of new Guaranteed Standards. This static model is based on a snapshot of suppliers' performance in delivering reliable switching in the last calendar year for which data is available (2017) and data on fixed and variable costs returned by suppliers.

1.5. Our assessment of the total benefits was calculated from our own analysis of the expected occurrence of the events that would trigger compensation payments in our Guaranteed Standards, and data returned from our Request for Information (RfI), with an uplift added as appropriate. This methodology is set out in our Impact Assessment document. We have not changed the methodology used to calculate benefits.

¹ See "Supplier Guaranteed Standards of Performance: Approach to Impact Assessment on Introducing Switching Compensation" at https://www.ofgem.gov.uk/system/files/docs/2018/06/supplier_guaranteed_standards_of_performance_approach_to_impact_assessment_on_introducing_switching_compensation_for_publication.pdf, pp6-12

² See "Supplier Guaranteed Standards of Performance for Switching: Impact Assessment" at https://www.ofgem.gov.uk/system/files/docs/2018/11/impact_assessment.pdf.

1.6. Table 1 below shows our assessment of the benefits under our revised proposals for Guaranteed Standards A, C and E. Under our revised proposals, only the gaining supplier will make a compensation payment if it fails to meet the terms of Guaranteed Standards A and C. We have elected to maintain the compensation payment made by the gaining supplier at a single Standard Payment of £30.

1.7. The principal effect of our revised proposals is that the estimated benefits of the proposal is reduced to £59.2 million per annum (based on 2017 data) from £72 million per annum. The reason for this is that under our revised proposals there is no longer be a transfer from losing suppliers to consumers in the event of a breach of Guaranteed Standards A and C.

1.8. The existing Standard Payment of £30 from the gaining supplier aligns the incentives for delayed and erroneous switches with the other Guaranteed Standards, and our view is that this standard payment represents an appropriate amount of compensation for the customer for detriment suffered as a result of the failure of an individual supplier to meet any of these Guaranteed Standards. Whilst our initial proposals from the June 2018 consultation proposed an additional payment of £15 from the losing supplier to be paid at the same time, based on our further analysis we do not believe that this is warranted.

1.9. Whilst this represents a reduction in the benefit provided to customers when compared with the proposal in the June 2018 consultation, by more effectively targeting those parties who are responsible for the detriment, it is more likely to effectively penalise poor performance by suppliers. If suppliers are subject to a Guaranteed Standard which is poorly targeted, they will be less able to avoid incurring these costs through effective validation and other good switching practice and more confident that these costs will be incurred by their competitors equally, and therefore more likely to pass on the costs of the compensation requirement for compensation to customers.

1.10. In our previous Impact Assessment, we noted that we would expect competition in the retail energy market to prevent suppliers from passing on the costs of Guaranteed Standards to consumers. Ensuring that responsibility for compensation is borne by the parties who are responsible for causing detriment is essential for ensuring that suppliers are less able to pass these costs directly to consumers. Suppliers' costs should vary with the extent that they breach the Guaranteed Standards, and the degree of efficiency with which they implement measures to prevent detriment at source. This will penalise those suppliers who are most responsible for detriment relative to others, which in turn will reduce the overall incidence of delays and erroneous transfers and lead to better outcomes for consumers.

1.11. Targeting these remedies at gaining suppliers, who (based on the assessment of the Working Group) are more likely to be responsible for the causes of delayed switches or erroneous transfers, will mean that the Guaranteed Standard is better targeted at source of detriment.

1.12. We have not included the impact of Additional Standard Payments in this analysis. Additional Standard Payments are made where a supplier fails to make a Standard Payment within 10 working days of it falling due. Their incidence is difficult to assess on an *ex ante* basis, and for this reason we have not included them in this model. However, it is reasonable to assess that they will represent an additional transfer of benefits from supplier to consumer in addition to the amount calculated below.

Calculation of estimated costs of the proposed Guaranteed Standards

1.13. In our Approach to Impact Assessment document, we outlined that since most of the Guaranteed Standards corresponded to existing requirements of licence conditions, we did not consider that the cost of adhering to those standards should form part of the calculation when assessing the balance of costs and benefits of these processes. This remains our view.

1.14. In our Request for Information (RfI) and previous Impact Assessments, we argued that the relevant additional costs of implementing these Guaranteed Standards is limited to the those costs where there is no corresponding licence condition to the Guaranteed Standard, in addition to the cost of building a payment mechanism to execute compensation payments required under the Guaranteed Standard.

1.15. Since publishing this impact assessment, it has been brought to our attention that some respondents to the original RfI may have excluded the costs of Change of Tenancy (CoT) events in their estimation of costs (and benefits), due to the belief that these events were excluded from the scope of the Guaranteed Standards.

1.16. We have since contacted respondents to the original RfI and have asked them to confirm whether they included CoT events in their original estimation of costs and benefits, and to provide any additional evidence to support a revised assessment. Whilst some did include CoT events, others did not. The suppliers who indicated that they did not include CoT events in their original assessment of costs did not provide further evidence relating to the scale of these costs.

1.17. As a result, it is possible that some costs of implementing the new Guaranteed Standards will not have been included in our original assessment. However, we consider that these costs are unlikely to be sufficiently significant to revise our analysis, for the following reasons:

- As we have previously stated, we have not included the costs of compliance with existing standard licence conditions as a relevant cost, as suppliers should already have measures in place to comply with them and also to monitor compliance. Under the terms of the Gas and Electricity Supply Licences, suppliers are required to send all customers a final bill within six weeks of a supplier transfer *or termination of a domestic supply contract*. Therefore CoT events would fall within the scope of the licence condition.
- A significant proportion of the relevant costs relate to the fixed cost of establishing the Guaranteed Standards. These will not differ (or will not differ significantly) whether the Guaranteed Standards are applied to CoT events in addition to Change of Supply (CoS) events.
- In our original estimate of costs, the total variable cost of applying the Guaranteed Standards to Change of Tenancy events was only a small proportion of the total relevant cost of introducing the Guaranteed Standards (an annual cost of £1.1m from a total of £20.9m). Including these costs is therefore unlikely to have a sufficiently large effect to change our overall assessment of net costs and benefits.
- The same RfI collected data on the benefits of introducing the Guaranteed Standards. Where suppliers have excluded CoT events from their estimates of cost, it is reasonable to assume that they have also excluded them from the benefits. Whilst these variable costs may see a small increase in the total costs of implementing the Guaranteed Standards, we would also expect to see an increase in the total benefits accrued to suppliers.

1.18. For this reason, whilst suppliers have not provided additional data to allow us to quantify the cost impact of the inclusion of CoT events, based on the previously available

information we do not feel that it is likely that the additional costs would be significant enough to warrant changing our decision to proceed with the Guaranteed Standards.

1.19. Table 2 below shows our assessment of the likely impact of the addition of CoT events into our assessment the cost impact of Guaranteed Standards from the previous Impact Assessment. In addition, our cost calculations from the previous Impact Assessment is reproduced in Appendix 1.

Revised comparison of costs and benefits

1.20. Based on the analysis above, we remain of the view that the aggregate benefits of introducing Guaranteed Standards will considerably exceeds the aggregate relevant costs (fixed and variable) that we have identified, even after reducing the aggregate benefits to reflect lower levels of transfer from suppliers to consumers in the event of a failure of Guaranteed Standard, and the potential for a small increase in relevant costs to account for Change of Tenancy events.

1.21. Under the revised Guaranteed Standards, we would expect to see £59.2 million worth of benefits in a calendar year (excluding any unquantified benefits from uncounted CoT events). By comparison, the first year implementation costs, (excluding unquantified costs from uncounted CoT events) would be unchanged at £20.9m in the first year following implementation.

1.22. The fixed costs of implementing the Guaranteed Standards will have been incurred by suppliers ahead of implementation in May 2019. As we stated in our previous Impact Assessment, these one-off setup costs will not be repeated in future years, and the costs incurred by new entrants might reasonably be expected to be lower.

1.23. Based on this static assessment of 2017 data we would therefore expect to see £38.3m of benefits in excess of the relevant costs accruing to customers in the calendar year following implementation.

Table 1: Expected annual benefits accruing from revised Guaranteed Standards

Proposed new performance standard		Estimated incidence (2017 data)	Potential total repayment to customers as per original proposal	Change from June 2018 consultation proposal	Potential total repayment to customers as per revised proposal
Implemented in May 2019	(B) To agree whether a switch is valid or erroneous within 20 working days of identification of the possible erroneous switch.	44,600	£1.3m (New Supplier) £1.3m (Old Supplier)	No change, implemented May 2019	£1.3m (New Supplier) £1.3m (Old Supplier)
	(D) To send the Erroneous Transfer Customer Charter "20 working day letter" to an erroneously switched consumer.	19,580	£0.6m (Contacted supplier)	No change, implemented May 2019	£0.6m (Contacted supplier)
	(F) To refund credit balances within ten working days of sending the final bill.	196,900	£5.9m (New Supplier)	No change, implemented May 2019	£5.9m (New Supplier)
	(A1) To return an erroneously switched customer within 21 working days of identification of an erroneous switch.	837,000	£25.1m (New Supplier) £12.6m (Old Supplier)	No change, implemented May 2019	£25.1m (Gaining Supplier)
(A) To ensure a switch is completed within 21 calendar days from the date the consumer enters into contract with gaining supplier unless there are valid reasons for delay to switch	Consultation responsibility now falls exclusively on gaining supplier.				
For implementation in winter 2019/20	(C) To ensure a consumer is not erroneously switched	89,000	£2.7m (New Supplier) £1.3m (Old Supplier)	Consultation responsibility now falls exclusively on gaining supplier.	£2.7m (Gaining Supplier)
	(E) To issue final bills within six weeks of a switch	744,000	£22.3m (Old Supplier)	No change.	£22.3m (Losing Supplier)
	Total annual incidence/benefit for these measures	1,867,824	£73.1m		£59.2m

Table 2: Expected changes from inclusion of Change of Tenancy costs

Cost category	Fixed (one-off) costs		Variable (annual) costs	
	People (£000)	IT/ Systems (£000)	People (£000)	IT/ Systems (£000)
1 Cost of establishing, or extending a mechanism for implementing Guaranteed Standards and compensation	No change	No change	No change, or small/negligible increase in costs	No change, or small/negligible increase in costs
2 Expected cost of reporting performance to Ofgem and Citizens Advice.	No change	No change	No change	No change
3 Expected cost of updating marketing and customer facing materials	No change	No change	No change, or small/negligible increase in costs	No change, or small/negligible costs
4 Costs of complying with, and monitoring performance of a requirement to refund credit balances within two weeks of issuing a final bill.	No change	No change	Potential for small increase in costs	Potential for small increase in costs
5 Costs of ensuring that a switch is completed within 21 days from the date the consumer enters into contract with gaining supplier, or from date an erroneous switch is agreed, rather than within 21 days of the 'relevant date'	No change	No change	No change	No change

Appendices

Index

Appendix	Name of Appendix	Page No.
1	Estimates of costs of implementing Guaranteed Standards	9

Appendix 1

Estimates of costs of implementing Guaranteed Standards

1.1. This appendix shows the calculation of the costs of introducing our Guaranteed Standards regime, based on our original assessment of supplier data. It is reproduced from our Impact Assessment document.³

Table A1: Costs of implementing Guaranteed Standards (source: supplier data in Request for Information)

Cost category	Fixed (one-off) costs			Variable (annual) costs			TOTAL FIRST YEAR COST
	People (£000)	IT/ Systems (£000)	TOTAL FIXED (£000)	People (£000)	IT/ Systems (£000)	TOTAL VARIABLE (£000)	
1 Cost of establishing, a mechanism for implementing Guaranteed Standards	1,217	2,777	3,994	2,040	232	2,273	6,267
2 Expected cost of reporting performance.	150	536	686	126	46	172	858
3 Expected cost of updating customer facing materials	218	3,757	3,975	272	2,365	2,637	6,612
Total cost of implementing new standards	1,585	7,070	8,655	2,438	2,643	5,082	13,737
4 Costs of complying with, a requirement to refund credit balances within two weeks of issuing a final bill.	398	1,741	2,139	1,020	145	1,164	3,303
5 Costs of ensuring that a switch is completed within 21 days from contract entry rather than the 'relevant date'	705	2,063	2,768	858	238	1,096	3,864
TOTAL	2,688	10,874	13,562	4,316	3,026	7,342	20,904

³ See "Supplier Guaranteed Standards of Performance for Switching: Impact Assessment" at https://www.ofgem.gov.uk/system/files/docs/2018/11/impact_assessment.pdf.