Gemserv

Sent by email to licensing@ofgem.gov.uk

Industry Codes and Licensing

Ofgem

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London E14 4PU

03 December 2019

Dear Vlada Petuchaite & James Proudfoot,

Supplier Licensing Review: Ongoing requirements and exit arrangements

We welcome the opportunity to respond to the above consultation. Gemserv has extensive experience of the energy sector and is an expert in the inter-operation of the industry codes and market participants. In particular, we have deep knowledge through managing the MRA (Master Registration Agreement), the SEC (Smart Energy Code), the IGTUNC (Independent Gas Transporters Uniform Network Code) and the GDAA (Green Deal Arrangements Agreement). We also have experience from across the wider energy market and other regulated industries. We have been at the heart of the energy market for over 20 years and during that period we have seen the entry and exit of a number participants, so we have first-hand experience of the impact on the market of any disorderly or disjointed influences and we welcome the proposals put forward in this consultation as a step towards better managing admissions and departures.

Executive Summary

Broadly, Gemserv endorses the proposals for improving resilience and considers it an appropriate step to signal the standards expected of suppliers as providers of an essential consumer service. The framework is consistent with assurance regimes employed in other energy markets as well as other sectors and we advocate the GB supply market moving in the direction of instilling the rigour of ongoing assurance during market operation. We are of the view that the principles are proportionate and facilitate suppliers being able to make their own informed decision on the appropriate measures for their business.

We hold the view that it is fitting that the new principles are articulated into the licence regime: it designs-in good practice and provides transparency that a licensee has such a duty of care to consumers and the market. The framework provides a useful structure for each supply business to apply according to its business model and is neutral to innovation: an essential element in an advancing technological market.

The consultation acknowledges that it is seeking to strike the right balance between vesting decisions to individual supply businesses as to the models and the scale of the measures they should have in place to

provide adequate protections. We support the concept of the means of underwriting the protections falling to the individual supplier, granting that, ultimately, our preference would be to see tangible guarantees in place, such as insurances or securitisations. Accordingly, we would suggest that Ofgem consider a post-implementation review to see how the new regime has performed in light of any 'near-misses', inadequate guarantees/bonds or unforeseen failures. This would also accord with:

- the open and co-operative principle since it could test when proactive engagement should be considered to mitigate any potential disruption when a company is experiencing difficulty;
- the value of a living will proposal since tangible pledges might be more effectively administered; and
- the efficacy of the framework of measures, both in terms of timeliness and outcome.

The milestone checkpoints for assessment are helpful pointers. It is our view that the key tenet of the framework is the practice of appropriate scrutiny and response to changing conditions throughout the life-cycle of operation. Applying this good practice will contribute to orderly market exit where that is unavoidable. Meaningful self-reporting could also be introduced alongside the new conditions, for example a declaration that the operational capability condition is being fulfilled. Although this may not, of itself, be prophetic, nor would a potential susceptibility or vulnerability be inferred it reinforces the expectation that this is maintained and risks are managed. However, the inclinations of organisations facing difficulty would perhaps be to seek to resolve an issue as a priority. Hence, it is our view that it may be prudent to ensure that it is clear that the frequency of any risk assessment is based around a range of contributing factors, not just time, to ensure pre-emptive techniques are applied to address potential issues.

We are also of the view that there would be benefit in issuing exit guidance along the lines of the supplementary guidance issued as part of the SLR final proposals for new entry requirements. Such material can reference other expectations not articulated in the licence drafting, for example the behaviour of appointed administrators in chasing debt from customers of a failed supplier.

At the end of the day, unexpected failures and exits cannot be entirely prevented. Moreover, risk-appetite will differ across businesses and the regulator. The important factor is proactively managing the risk and having adequate protections. This can be achieved with a blend of:

- insurance(s) to safeguard the business against unexpected loss or damage – we think Ofgem should consider whether the provision of insurance product(s) provided on commercial terms could drive cost efficiencies and improved outcomes when compared with alternatives;
- assurance to the regulator and the market on the robustness, efficiency and effectiveness of a company's policies and operations, and in turn striking the right balance between protecting stakeholders from the impact of supplier failures on the one hand, and ensuring competition and innovation on the other; and

- confidence as to the status of individual or market compliance with the licensees' statutory obligations.

Finally, we would further recommend that Ofgem consider how the industry codes can underpin these new licence conditions. In keeping with the aims of innovation and the Codes Review, existing or new code entities could engage with other sector models for insight into the type of schemes and tools that could be deployed, much as Ofgem previously looked at the financial sector in their earlier considerations. Indeed, there are a range of techniques employed in the insurance sector that could serve as useful references. That is not to say that there will be a one-size solution, but to inform on a range of options for code stakeholders, including but not limited to:

- code governance bodies who oversee performance or compliance;
- suppliers – whether new, growing or long-established – of the techniques and products available to them;
- prospective new applicants.

We have provided some further thoughts on the questions in the annex to our response, which we hope you will find helpful. Gemserv would be delighted to discuss our response with you and further explore some of our ideas on this area of operations.

Yours thankfully,

Jill Ashby
Design & Enterprise Principal
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Appendix: Gemserv's response to the Supplier Licensing Review: Ongoing requirements and exit arrangements consultation

Q1 ***Do you think the proposed package of reforms will help to reduce the likelihood of disorderly market exits, and the disruption caused for consumers and the wider market when suppliers fail? Are there other actions you consider we should take to help achieve these aims?***

The reforms reinforce the expected standards and support the aim of better managed exits than hitherto experienced. The proposed operational capability licence condition is a candidate for enabling further reporting on the ongoing resilience of a supplier, for example through annual statements on compliance with that condition. Other markets may provide useful examples of such annual testimony as part of ongoing performance assurance.

However, it is likely that failures will still occur and we would like to see a guidance document to underpin a managed exit, where possible. Such guidance could expand on the principles that prudent measures should be taken to safeguard the market and consumers from the detriment of supplier failure. The guidance could also reinforce the view noted in the consultation that energy suppliers are providers of an essential consumer service. Ofgem may like to produce such guidance from their perspective and the relevant codes could also be requested to consider how they could contribute by producing managed-exit procedures and/or practice guidance.

Q2. ***Do you agree with the outputs of our impact assessment?***

Q3. ***What further quantitative data can industry provide to inform the costs and benefits of the impact assessment, particularly for cost mutualisation protections?***

Q4. ***Do you agree with the assumptions used to calculate the costs and benefits in our impact assessment? If not, please provide evidence to support further refinement.***

Party stakeholders are best-placed to provide feedback on the quantitative data and the cost calculations in the impact assessment. Broadly, we concur that there are benefits, although would observe that these are likely to accrue in accordance with the integrity of the management measures and solutions adopted by each supply business.

As we note in our comments on Q5, we are of the view that the options should be further explored and evaluated.

Q5. ***Do you agree with our proposed option to cost mutualisation protections? Are there other methods of implementing this proposed option? Please provide an explanation and, if possible any evidence, to support your position.***

Including a requirement to protect a percentage of customer credit balances enhances accountability to mitigate consumer and market detriment in the event of exit. It would benefit from further clarity on the practical operation of this measure to ensure that it is appropriately managed. For example, balances rise and fall in the cycle of customer account administration and any ambiguity should be avoided as to how/when this percentage is to be measured if this is to be effective. Improved risk management will also contribute to better practices and controls to ensure prudence in handling finances fittingly.

We acknowledge the other referenced mutualisation schemes, and in the interests of transparency, would not like these to be considered in isolation. There are a range of options available today and it is likely that new offerings may emerge as the take-up of this new scheme evolves. As the consultation notes, some of the protection routes may be less readily available for some suppliers and exploring the costs and merits of each 'headline' approach further would be useful to better evaluate the options and any unintended consequences. Other sectors also may provide useful illustrations of approaches or techniques that can be considered. It may be beneficial to consider this proposed option in the round of the other proposals too: for instance, in the spirit of being open with the regulator, making a declaration of coverage for protection of credit balances as part of the suite of reporting to Ofgem. We would further observe that the 'menu' of protection measures need not be mutually exclusive. Indeed, it may be prudent to diversify any such portfolio and certainly to review it as part of the ongoing requirement to maintain operational capacity and manage risk. We recommend that Ofgem and the market keep a watching brief on the products and solutions that may develop.

The scope of risk management protections should take all due account of others' exposure through any Code or regulatory provisions. Perhaps reference to the wider spectrum would be a useful candidate for any guidance material, whether issued by Ofgem or in collaboration with the relevant Code(s).

Q6. ***Do you agree with our proposal to introduce new milestone assessments for suppliers? Do you think the milestones we have proposed and the factors we intend to assess are the right ones? Are there additional factors we should consider to help us to identify where suppliers' may be in financial difficulty?***

We strongly support the introduction of milestone assessments as this reinforces that supply businesses should be monitoring their business model and market progress with the aim of resilience. Regardless of the new regime, we advocate the use of 'health checks' as a prudent measure throughout the lifecycle of market operation and believe they can serve as an indicator of any change in risk profile relating to operational, financial or capacity resilience, thereby enabling early action to be considered. It would also be unfortunate if the trigger points were seen as a limit of the assurances this proposal seeks to introduce, or that financial

difficulty is the only factor that may occasion further assessment. To this end, consideration should be given to reporting on the operational capability licence condition as a means of assuring ongoing compliance and preparedness.

We are also minded that new supply companies may have acquired 'off-the-shelf' solutions to facilitate their entry to market and these are helpful aids to encourage prospective licensees. However, such products do not purport to be an exhaustive offering or service and would recommend the assessments (both prior to market entry and thereafter) include reference to the planned integration and evolution of any initial technical or operational model as the business grows. Whilst this may be implicit in the new operational principle, it would be beneficial to have clarity of this expectation – perhaps in supplementary guidance material.

Q7. ***Do you agree with our proposal to introduce an ongoing fit and proper requirement? Are there additional factors, other than the ones we have outlined, that you believe suppliers should assess in conducting checks?***

We support the emphasis on ensuring good corporate governance and that appropriate oversight be built-in to both the conduct and management information of Boards and their ancillary corporate entities.

Q8. ***Do you agree with our proposal to require suppliers to produce living wills? What do you think we should include as minimum criteria for living will content?***

A living will concept is a useful step in ensuring that a supply business has understood that it should make prudent provisions in the event of its 'end-of-life' market exit.

As with any will, or directive, it is a statement of wishes as to how any residual estate will be managed out to any beneficiary. As such, an observation would be that any such declaration is dependent on the circumstances in the process of demise, which may not outturn as envisaged at the time of striking the living will. Consequently, our recommendation would be that the existence of such a document does not mean that it, in itself, should be excluded as a line item in any risk-management under the ongoing requirements. We appreciate that the licence condition may not be an appropriate vehicle to specify this and propose that this be clarified in supplementary guidance.

Regarding the suggestion of a public disclosure, albeit abridged, we are less convinced this will be useful and could be misunderstood by consumers. To the extent that any declaration of such a document was required we are of the view that this could be provided to a relevant code and the REC would be a good home, or one of the other codes (such as the MRA which already houses the SoLR provisions) pending any future Code Consolidation.

A suggestion for consideration of other criteria might be who would act as an "executor" and therefore responsible for administering the provisions. This could be helpful, particularly if enacted when the failing business is already compromised. In this case, nominating a 'responsible officer' in the living will could be an approach.

We further note the example of a methodology for the SoLR process may be a candidate for the content of a living will. In this regard, a criteria for this methodology might include smart meters as there are additional factors to consider in administering any handover of data or control of the devices. We also note that Ofgem plan to discuss splitting a failed supplier's portfolio in a SoLR scenario (see Q11) and we suggest this be considered for the living will. Whilst a failing supplier may not be aware whether any portfolio segmentation will be applied any methodology could, at a high level, factor in this possibility.

Q9. *Do you agree with our proposed scope for independent audits? Please provide rationale to support your view.*

Independent audits may be useful, depending on when in the process such an intervention might occur. The scope should certainly include any financial concerns raised by Ofgem. As to auditing the day-to-day operations in light of any concerns, we support the concept of an external assessment and consider that this could be a function of a relevant code (for example through an instruction to its existing performance assurance regime) if this were to provide a swifter appointment.

We recognise that the consultation is predicated on Ofgem's role although issues might also arise through a code body, should they become aware of a potential difficulty. This might be from their monitoring of their parties' performance rather than the market reporting to Ofgem. Any information as to a potential issue from an accepted source may be helpful to the aim of early intervention. To this end, liaison in respect of the new exit regime arrangements between Ofgem and the codes is recommended.

Q10. *Do you agree with the near term steps we propose to take to improve consumers' experience of supplier failures? Are there other steps you think we should be taking?*

Where the cut-across with administrator duties in the case of a failed supplier and the smooth operation of the SoLR has been impacted, we support the principle that consumer protections should be consistent with those in the supply licence. Making provision for these within consumer contracts as a backstop for appropriate debt-recovery behaviour could be helpful, noting that consumer awareness will be key to its effectiveness.

Given that the consultation notes that Ofgem do not regulate administrators, this aspect may also be a candidate for a living will if this proposal is taken forward. For example, including an objective that, in the event of administrators being appointed, they will respect the debt recovery protections afforded in supply

licences. This could also be part of any public disclosure to promote consumer confidence if things go wrong with their supplier.

Q11. ***Do you think there is merit in taking forward further actions in relation to portfolio splitting or trade sales? What are your views of the benefits of these steps? Are there any potential difficulties you can foresee?***

There is some capability within the central market systems to identify and disaggregate a supplier's portfolio and, if this brings benefit to the choices within the SoLR process, this should be explored. We note the participants intended in the first round of discussions and are of the view that the discussions could also usefully include the Smart Energy Code , for example for any potential security or SMKI implications to be considered in the round. Moreover, we consider that future factors that might occasion splitting a portfolio could be markedly different from the traditional categories, for example with EV, 'V2G' and DSR packages. Whist such packages may still fall within the wider bounds of the domestic or non-domestic sectors, consumers who have availed themselves of such retail arrangements may well be better served by a segmented SoLR or trade sale to a business model that includes similar market segments. Thus, we support portfolio splitting as a potential resolution for better consumer benefits in managed exits.

In the fullness of time, it is worth considering whether the Retail Energy Code (and CRS/CSS) could also usefully play a part in facilitating portfolio splitting or expediting central processing for trade sales to support efficiencies in SoLR circumstances.

Q12. ***Do you think our draft supply licence conditions reflect policy intent?***

The drafting broadly reflects policy intent, although we consider that there would be additional benefit in it being underpinned by guidance or explanatory notes on the expectations of the principles and requirements.

Gemserv
3rd December 2019