

Sent by email to licensing@ofgem.gov.uk

Industry Codes and Licensing
Ofgem
10 South Colonnade
Canary Wharf
London
E14 4PU

20 August 2020

Dear Sir/Madam,

Statutory Consultation - 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 trading arrangements 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, gaining 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 risk and supplier departures.

Executive Summary

Broadly, Gemserv endorses the proposals and licence drafting put forward in the consultation and considers them an appropriate step to promote responsible risk management and increased supplier-accountability to ensure high standards are adopted across the market.

We are supportive of the use of principles-based regulations and measures that offer a proportionate approach to risk management for all suppliers to assist in ensuring consistent high standards across the market.

Generally, we consider the principles are proportionate and enable suppliers to make informed decisions on the appropriate measures for their organisations. The focus on principles-based requirements provides a useful structure for each supply business to apply according to its business model and should not hinder innovation: an essential element in an advancing technological market. The inclusion of these principles into the licence regime designs-in good practice and provides transparency of Ofgem's expectations of licensees for the management of financial risk and customer service.



The consultation acknowledges that it is seeking to strike the right balance between vesting decision-making to individual supply businesses as to the models and the scale of the measures they should have in place to provide adequate protections. We would suggest that Ofgem consider a post-implementation review to see how the new regime has performed in light of any 'near-misses', inappropriate 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 Customer Supply Continuity Plan (formerly known as Living Wills) proposal as tangible pledges can be more effectively administered;
- the efficacy of the framework of measures, both in terms of timeliness and outcome; and
- feedback from the supplier community.

Unexpected failures and exits cannot be entirely prevented. Moreover, risk-appetite will differ between suppliers and the regulator. It is key that risks are proactively managed, there are adequate protections and a common understanding of requirements between parties. We believe this can be achieved with a blend of:

- insurance to safeguard the business against unexpected loss or damage;
- assurance to the regulator and the market on the robustness, efficiency and effectiveness of a company's policies and operations;
- confidence as to the status of individual or market compliance with the statutory obligations; and
- proportionate, clear principles that outline regulatory obligations, but maintain flexibility for different supplier models.

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 four key areas discussed in the consultation in the Appendix 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 considerations.

Yours thankfully,

Richard Nichols
Senior Consultant

E: richard.nichols@gemserv.com



Appendix: Gemserv's response to Statutory Consultation - Supplier Licensing Review: Ongoing requirements and exit arrangements

Promoting Better Risk Management

Cost Mutualisation

We support the introduction of a Financial Responsibility Principle to drive desired behaviours to promote better financial management to require suppliers to proactively manage their finances effectively to reduce mutualised costs if they were to fail. Where suppliers are not managing finances effectively, it is prudent for Ofgem to intervene and take early action.

The flexible nature of the principle is sensible given the range of supplier models in the market to reduce the impact of the principle on suppliers. Given the importance of effective financial management, especially within the current economic climate, we are supportive of the proposal for no implementation period for this principle. However, we note Ofgem states it may publish guidance on how suppliers could meet this principle. We would suggest this is done prior to the principle coming into force to streamline its implementation and support suppliers.

The proposed supply licence drafting for the Financial Responsibility Principle does not include the guidance bullet points within the "Final Proposal" section listed on page 22 of the consultation. These bullets are noted as being minimum actions to complete to comply with the new principle. For ease of supplier implementation and Ofgem monitoring we recommend including these bullets within the supply licence drafting for this principle.

We also note Ofgem is considering more prescriptive requirements around credit balances which will require careful consideration and further consultation with stakeholders. Given the divergence in feedback received from stakeholders during the previous policy consultation around this point and the potential changes for suppliers we are supportive of this approach.

There are a range of options available today such as a market wide insurance scheme and we recommend that Ofgem engages with other sector regulators to learn lessons from other markets that could provide solutions. As we did at the start of the year, we would be happy to discuss possible market solutions to the cost mutualisation point if Ofgem would like to explore further prescriptive measures.

Operational Capability Principle

We are supportive of the operational capability principle and its aim to ensure suppliers have robust capabilities, systems and processes in place to enable them to meet regulatory obligations and serve their customers.

Again, the use of principles-based requirements will help to reduce the impact of the principle on the various supplier business models operating within the market. We agree with Ofgem's note that this principle is likely to impact poor-performing suppliers more than those already operating with robust capabilities and systems.

Ofgem notes this principle has various links with existing obligations and checks performed by Code bodies. As such, we consider whether there should be specific feedback loops for findings observed by Code bodies noted in the supply licence drafting to ensure information is shared with Ofgem in a timely manner.



We also support the update to the supply licence drafting which makes clear the operational capability principle is an ongoing obligation.

Milestone and Dynamic Assessments

We strongly support the introduction of milestone assessments as this reinforces the principle that supply businesses should be monitoring their business model and market progress with the aim of resilience.

As noted in our previous consultation response, we advocate the use of these assessments as a prudent measure throughout the lifecycle of supplier market operation and believe they can serve as an indicator for any change in risk profile relating to operational, financial or capacity resilience, thereby enabling early action to be considered.

The reduction of proposed milestone assessment to 50,000 and 200,000 domestic customers reduces regulatory burden for suppliers, but also maintains appropriate oversight from Ofgem. The supply licence drafting's of supplier's obligation to notify Ofgem "a reasonable time before it reasonably anticipates" to reach 50,000 and 200,000 domestic customers also provides useful flexibility for suppliers in initiating these milestone assessments.

In order to provide further oversight of new entrants Ofgem may consider closer engagement with industry Codes, such as the MRA or in future, the REC. The MRA, for example, entry assessment team manages the Controlled Market Entry Assessment (CME) process, this process could be used to ensure areas covered under milestone assessment were addressed/flagged during the entry process or could promote extending the time suppliers spend in CME to provide greater oversight of, and support to, new entrants.

We are supportive of dynamic assessments to provide an opportunity for Ofgem to respond to specific concerns about supplier's financial sustainability or ability to serve their customers. This provides assessment opportunities past the 200,000 domestic customer milestone assessment threshold. This is a value tool to monitor the risk management of existing large suppliers and those suppliers who will exceed this threshold in the future, as it is arguably the largest suppliers could have the largest impact on the market if they failed due to poor risk management practices. We note dynamic assessments have not been supported by specific licence drafting and would consider whether licence drafting would be useful to support the enforcement of these assessments.

More responsible governance and increased accountability

Ongoing fit and proper requirement

We support the emphasis on ensuring good corporate governance and appropriate oversight built into the ethos of key decision makers supplier organisations. We agree that Suppliers are best placed to identify which individuals are making or influencing key decisions and to conduct initial assessment as to whether these individuals are fit and proper.

Whilst we appreciate the difficulty in defining "significant managerial responsibility or influence" for an industry we do think there is still some ambiguity in the definition within the proposed licence drafting. For large supplier organisations completing "regular" assessments on relevant individuals could be an administrative burden. Further clarity on the minimum timing requirements of these



assessments could be useful for suppliers to ensure assessments are undertaken in line with Ofgem's expectations.

We also consider it would be more appropriate for the licence drafting for this obligation to be revised to focus on "accountable" individuals rather than "responsible" ones. Responsibility can be shared amongst a number of individuals whereas accountability is specific to an individual depending on their skill set, role, or strengths. Attaching this obligation to an accountable person would reduce administrative burden for suppliers and focus the assessments on appropriately senior members of staff, whilst maintaining the assurance Ofgem desires.

Principle to be open and cooperative with the regulator

We support the principle that suppliers should work cooperatively with the regulator to highlight and address potential consumer detriment in a timely fashion.

Whilst the supply licence drafting remains broad, we consider this appropriate to avoid limiting the subject matter for engagement with the regulator.

Increased Market Oversight

Customer Supply Continuity Plans

A Customer Supply Continuity Plan 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. We consider the requirement for all suppliers to produce a Customer Supply Continuity Plan sensible to assist in preparations for an orderly market exit, should it occur.

Independent Audits

We are supportive of the use of independent audits as directed by Ofgem as a result of continued poor performance or an inability to provide adequate information to Ofgem. We believe the scope of both financial and customer service systems and processes is appropriate to provide a complete assessment of supplier risk management.

We are also supportive of the supplier's ability to select its own independent auditor. The licence drafting clarifications requiring suppliers to share a copy of the audit by a deadline set by Ofgem and the inclusion of the definition of independent audit are useful. We also support the requirement for auditors to be regulated by an appropriate professional body to ensure audits are conducted to a high standard to provide sufficient assurance to Ofgem on their quality.

We recognise 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, and this could be highlighted within the licence drafting.

Monitoring and Reporting Requirements

We are supportive of the requirement and licence drafting changes for suppliers to notify Ofgem in the event of specific changes that may arise in the course of running its business.



Exit Arrangements

Customer interactions with administrators

Where the cut-across with administrator duties in the case of a failed supplier and the smooth operation of the Supplier of Last Resort (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. We therefore support the licence drafting to ensure final bill requirements and detail on the terms and conditions are included in contracts.

We also support the suggestion to continue to engage with relevant insolvency regulatory bodies to work together where there are concerns regarding behaviour having consumer detriment.

Customer book sales

We recognise the rationale for Ofgem's potential involvement in transactions where partial book sales could result in poor customer experience or treating customers unfairly. We are supportive of the supply licence drafting requiring suppliers to notify Ofgem where they plan to undertake a commercial transaction which would result in the transfer of customers.

We note the proposed drafting states licensees must not undertake a Trade Sale or Trade Purchase that makes it more likely in the Authority's opinion that costs will be Mutualised. We believe there may be benefit to clarify that licensees will be able to provide evidence before Ofgem intervenes in customer book sales highlighting why it believes the sale does not increase the likelihood of cost mutualisation.

Other improvements to exit arrangements

We are supportive of the SoLR licence drafting amendments to require licensees to honour customer credit balances where they committed to do in their bid to become SoLR.

We also support the simplification of the Last Resort Supply Direction licence drafting.

Gemserv

20 August 2020