

Reducing credit balance mutualisation consultation workshop



15 April 2021

Item	Timing
Introduction	9.30 – 9.40
Background to our proposals	9.40 – 9.50
Overview of our proposals	9.50 – 10.05
Q&A	10.05 – 10.30
Polling and discussion	10.30 – 11.00
Break	11.00 – 11.15
More detail on threshold model	11.15 – 11.35
More detail on autorefund model	11.35 – 11.45
Q&A	11.45 – 12.05
Breakout session 1	12.05 – 12.25
Lunch break	12.25 – 13.30
Breakout session 2	13.30 – 13.50
Breakout session 3	13.50 – 14.10
Final plenary and close	14.10 – 14.30

Ensuring appropriate protections are in place against financial instability and poor customer service

2019

2020

2021

New entry requirements:

- Appropriate resources to enter the market – at least to end of first year of operation
- Understanding of obligations and a plan to meet these – statement of intent
- Fit and proper

New ongoing and exit requirements:

Risk management

- Financial Responsibility Principle
- Checkpoints
- Operational principle

Governance and accountability

- Fit and Proper
- Cooperation principle

Market oversight

- Audits
- Customer Supply Continuity Plans
- Changes of control reporting

Exit

- Rules on administration

Credit balance rules:

- Autorefund **(TBD)**
- Thresholds **(TBD)**

2019 proposals

- Proposed protection of fixed proportion of credit balances and scheme costs
- Responses split but widespread agreement that action required
- Strong views on cost of capital assumptions in draft IA – further analysis shows these are much higher than in draft IA

Our objectives

1. Minimise the likelihood and extent of cost to be mutualised in the event of supplier failure in most cost-effective way
2. Encourage more responsible business practices in the GB energy retail market
3. Ensure that suppliers bear an appropriate share of the cost of the mutualisation risk they pose to the market
4. Ensure that regulator costs do not unduly hamper good practice, entry, innovation, growth

Our new proposals

- Targeted at surplus credit balances as we consider these particularly distortive
- Would allow suppliers to collect the credit balances they require to serve their customers
- Consider these proposals meet our objectives
- Autorefund of credit balances above £0 after 12 months and a limit on credit balances suppliers can collect cost-free

*Inter year –
autorefund*

- Requiring suppliers to refund any credit balances above ~£0 at end of each year directly tackles surplus credit balances
- Analysis shows this will have significant impact as a roughly equal proportion of customers finish their contract in each month.

*Intra year –
thresholds*

- Autorefund does not stop individual accounts accruing at a significant surplus until month 12 so suppliers could use this to fund unsustainable business models.
- Thresholds would control shape of credit balances, particularly at point of greatest risk (Aug-Oct) when the RO falls due.

What they will achieve

- £1.4bn reduction in credit balances which would be returned to consumers
- Avoided mutualisation per SoLR of c£6m (not adjusted for inflation)
- Net benefit of £0.6 – 1.6bn over 10 years
- As well as reducing mutualisation, these measures avoid distributional impacts on smaller suppliers and new entrants, and incentivises better practice: more regular billing, meter reads, DD reviews

Q & A

GETTING YOUR THOUGHTS

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BREAK

THRESHOLD MODEL

Aim

- To set out draft thresholds based on data collected in our February RFI (which collected supply and credit balance data from between April 2018 and March 2019).
- To model the impact of customer contract start date on aggregate credit balances and set out a weighted version of our draft threshold.

Outputs

- **Annual thresholds:** sets out a weighted and non-weighted threshold based on the maximum credit balance position each year – typically falling in ~October
- **Monthly thresholds:** sets out a threshold for each month of the year. Suppliers would be required to comply with a different threshold at different points throughout the year. This follows the expected curve of a customers account balance. Thresholds are set out both weighted and non-weighted.

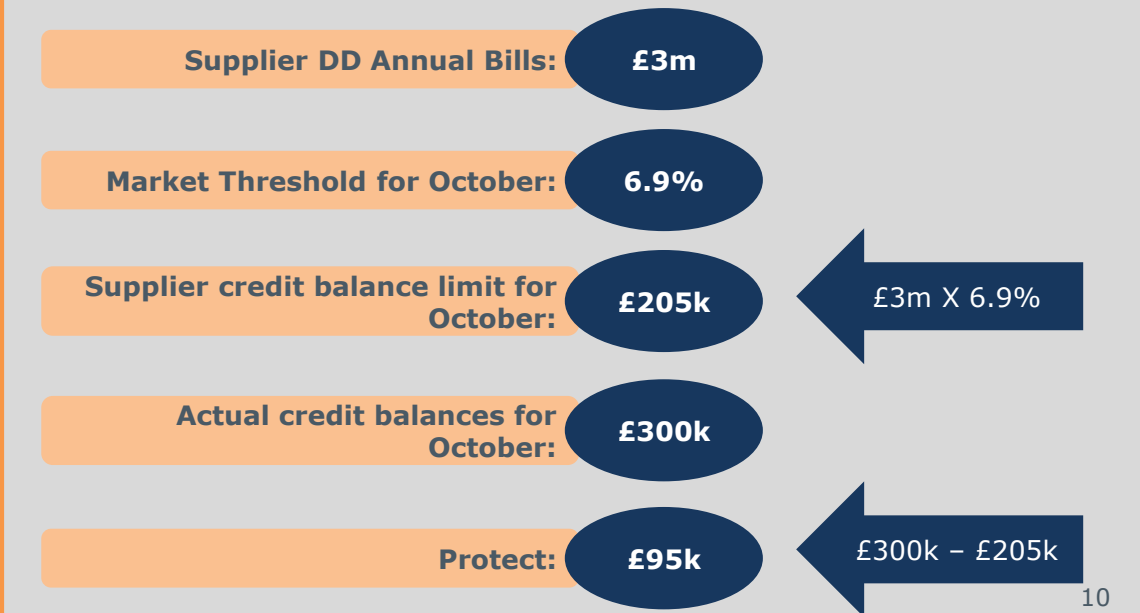
Model Design Principle

- **Simple and clear:** the model should not be overly complex and it should follow a clear design with minimal assumptions.
- **Bottom up approach:** built up from consumption and payment data to calculate the credit balance requirement annually and monthly.

Worked Example – application of outputs for supplier for October

Core Assumptions

- **Consumption:** That the aggregated market revenue data for 18/19 which we collected through our February RFI is indicative of the typical curve for most suppliers in most years.
- **Contract start dates:** that a similar number of customers start in each month as seen in historic switching averages.



Inputs

Revenue: This is the amount of a customer’s annual bill we expect consumers to use in each month of the year. It is based on an average of supplier monthly direct debit revenues as reported to us through our RFI in early 2020. (Shown as ‘Consumption’ on this slide)

Payments: Suppliers told us in response to our RFI that they calculate their fixed direct debit customers monthly payments by taking the customers annual bill and dividing it by 12. The model assumes that payments remain constant throughout the year.

Step 1: Net payments

This is the customer’s monthly payment minus (-) the customer’s monthly consumption.

Month	Month 1	Month 2	Month 3
Consumption	£70	£84	£111
Payment	£100	£100	£100
Net Payment	£30	£16	-£11

Step 2: Account Balance build up

How account balances build up/down. Positive net payments increase the balance and negative net payments reduce the balance. We do this based on a customer starting in each month in the year.

Month	Month 1	Month 2	Month 3
Net Payment	£30	£16	-£11
Calculation	£0 + £30	£30 + 16	£45 - £11
Account Balance Build Up	£30	£46	£34

Step 3: Isolate credit balances from debit balances

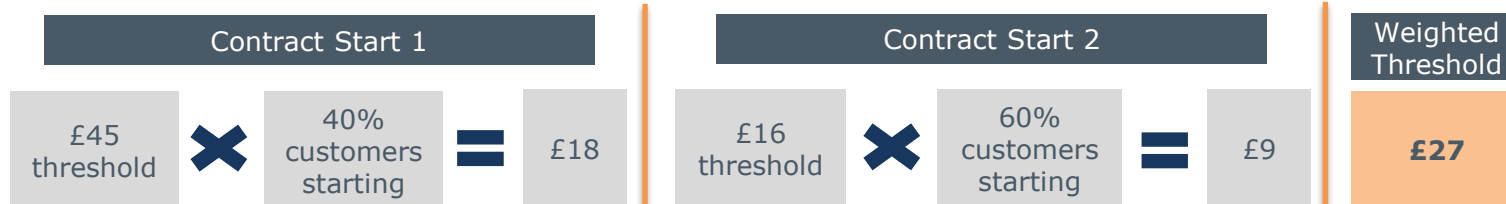
We isolate the credit balances by setting all negative figures to £0.

In this step we have used a new example assuming a winter start contract date.

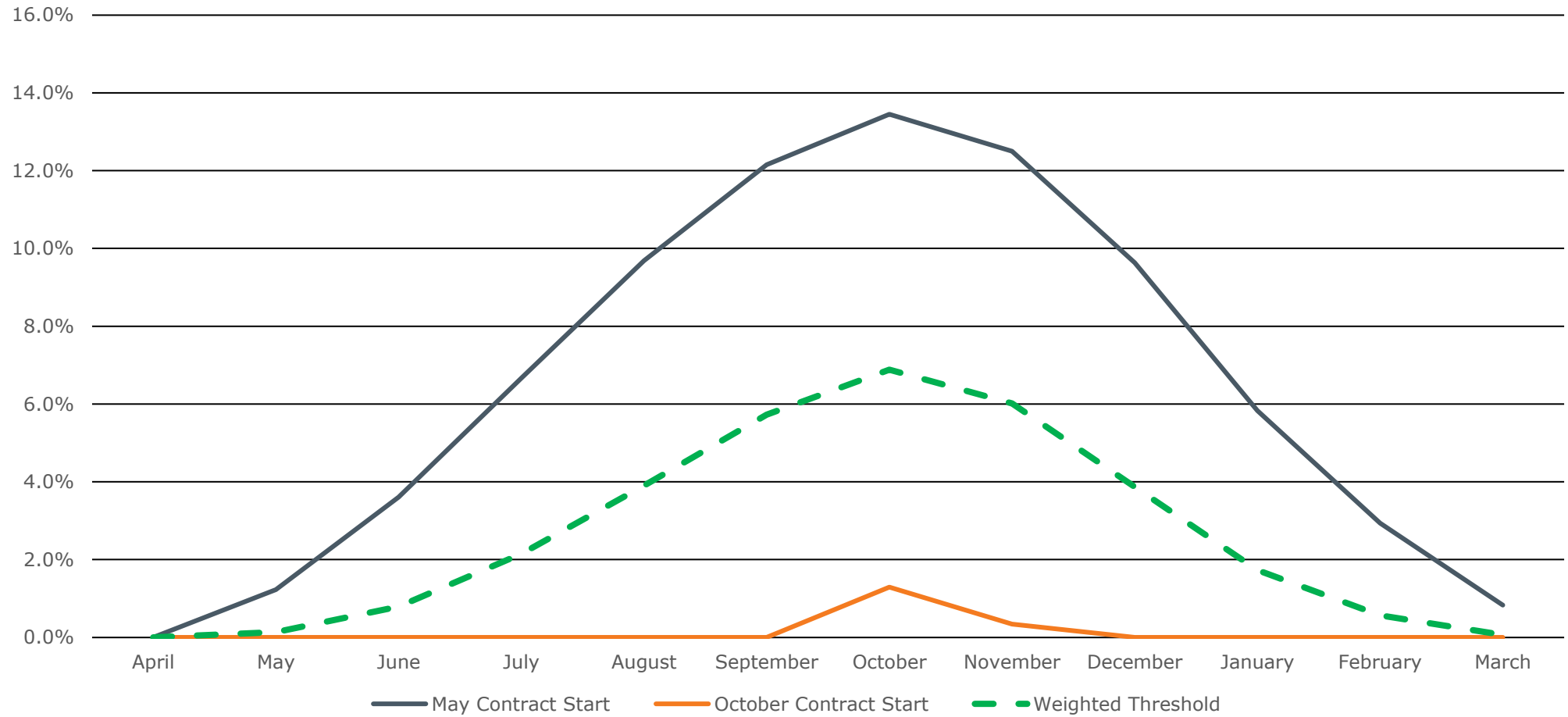
Month	Month 1	Month 2	Month 3
Net Payment	£16	-£11	-£34
Account Balance Build Up	£16	£4	-£30
Credit Balance	£16	£4	£0

Step 4: Weight for contract start date

We weight based on the number of customers expected to start a new contract each month of the year. This establishes a single weighted threshold.



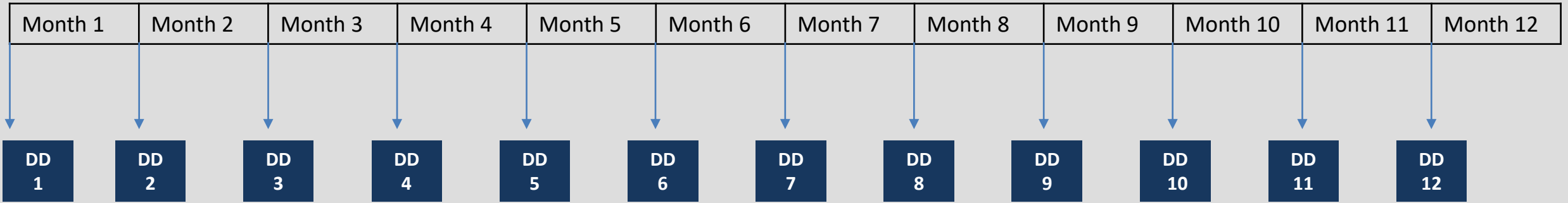
Weighted thresholds



AUTOREFUND

- Suppliers informed us in consultation responses and bilaterally that they set DDs so that accounts trend to £0 over 12 months
- Suppliers are currently obligated to set DDs accurately specifically taking account of consumption over the contract term
- Autorefund acts as a backstop; when an account hasn't ended at £0 after 12 months it is in surplus and this ensures that every year the account is reset and overpayments are returned to consumers
- This policy ensures that suppliers do not get a working capital benefit from surplus credit balances that can be mutualised across the rest of the market

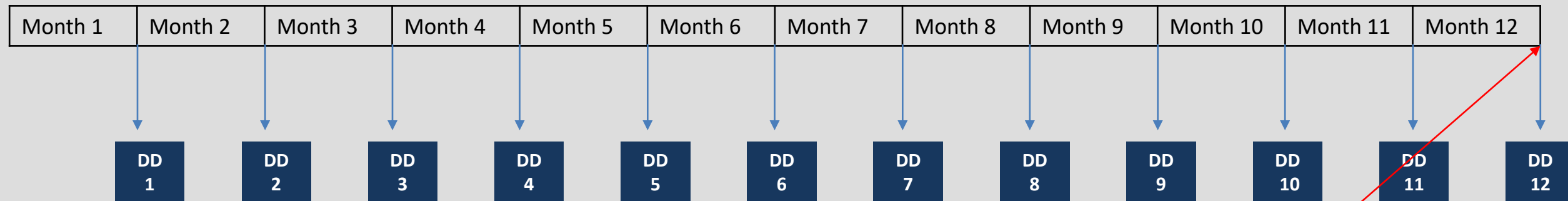
Payment in advance



Refund date is the anniversary of the customer's first payment because, regardless of payment model, both 12 month's of consumption will have occurred and the supplier will have received 12 payments

12 months' worth of consumption finishes 30 – 31 days after the 12th payment

Payment in arrears



Full year of consumption ends just before the 12th payment

- This policy treats payment in advance and arrears the same – it does not regulate payment in advance (if you operate that business model, the refund occurs and the next upfront payment occurs)
- Calculation occurs if the account is above £0 at the end of the year and is simply: (12 month's consumption) – (sum of 12 DD payments)
- This can be returned to consumer as a one-off payment or reflected in the next month's bill/payment (providing the amount is less than the DD)

Breakout 1: costs & benefits

Questions:

1. What do you think are the main costs of our proposals?
2. What do you think are the main benefits of our proposals?

Breakout 2: threshold model

Questions:

1. Do you think the threshold model delivers against its purpose?
2. How should we account for the variability of energy consumption and the factors which affect consumption in the threshold model?

Breakout 3: implementation

Questions:

1. What do you think is an appropriate implementation approach and timeline?

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