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Supplier Licensing Review: reducing credit balance mutualisation consultation workshop – summary notes

From: Robert Wilcox	Date of workshop: Thursday 15 April 2021 Time: 09:30 am	Location: Virtual

Background

As part of the Supplier Licensing Review, we are consulting on proposals for prescriptive rules to reduce the scale of credit balances at risk of mutualisation in the event of supplier failure. In March 2021, we published a policy consultation[1] setting out our proposals for suppliers to protect or refund any credit they hold above a certain threshold, and to refund any credit left over at the end of year of supply to a customer.

On April 15 2021, we held a workshop to gather stakeholder views on our proposals. Beginning with a general discussion and Q&A, we then held breakout discussions focused on the costs and benefits of our proposals, the model we used to create our proposed credit balance threshold, and implementation timescales for the policy. The workshop was attended by a range of stakeholders, including suppliers, industry bodies and consumer groups.[2] We also conducted live opinion polls before and after our discussions.[3]

The key discussion points from the workshop are summarised below. Please note that these are the views of workshop attendees, and do not represent the views of Ofgem.

[1] Ofgem, Supplier Licensing Review: reducing credit balance mutualisation (ofgem.gov.uk), March 2021
[2] A full list of attendees is included in Appendix 1
[3] Live poll results are included in Appendix 2

General discussion/plenary Q&A

Questions on autorefunds

- Suppliers asked about the effects the autorefund policy would have on advance-payment tariffs. As outlined in our consultation document, the proposed autorefund mechanism does not put such tariffs at a disadvantage compared to payment-in-arrears tariffs, as the refund does not take place until a full year of consumption has passed and 12 monthly payments have been made.

- Regarding the autorefund, suppliers requested clarity on what form it must take - whether it must be a cash refund back to the customer or if an equivalent discount on the next bill would suffice. As set out in the consultation, we propose that surplus credit from the previous year can be returned to the customer through a refund direct to their bank account or an equivalent deduction in the next payment provided all credit is returned in its entirety through a single action. Suppliers have discretion to choose whichever option achieves this better.

- Multiple suppliers raised concerns around not tying the autorefund to a meter reading for the year, leading to inaccurate refunds. We repeated the rationale from our consultation regarding why linking to meter readings could create peverse incentives for suppliers (to not collect reads and therefore not have to refund). We also expect the ongoing smart meter rollout to help minimise any possible risks. However, we requested that attendees put their arguments forward on why any refund should be tied to a meter reading in their consultation responses.

- Multiple suppliers raised the prospect of a partial autorefund (eg refunding down to £10). Our intent with the autorefund policy is to stop overpayment from one year carrying over to the next. If all surplus credit is returned to the customer at the end of a supply year, as proposed in our consultation, this aim is achieved. We are open to suggestions from stakeholders on providing some flexibility to this proposal. To clarify, our proposal is for any credit from the previous year of supply only to be automatically refunded - we acknowledge that, by this date, the customer may have accumulated some credit in the current supply year. This is not credit which should be refunded and, therefore, an autorefund will not necessarily reduce a customer's actual credit balance to £0 at the time of the refund.

- Suppliers asked how unpaid credits, such as the Warm Home Discount or sign-up bonuses, would factor into autorefunds. Our view is that sign-up bonuses would have to be refunded alongside credit the customer has paid in. The Warm Home Discount is something we will consider going forward.

<u>Questions relating to "the problem"</u>

- One supplier suggested that unsustainable tariff prices contribute to credit balance mutualisation in the market, and asked if Ofgem have considered implementing a price floor. We clarified that this is not something we are currently considering.

- Attendees asked about the scale of credit balance mutualisation in the past year and how it compares to previous years. We do not have a definitive figure at this time, due to the commercial sensitivity of very recent SoLRs, but we will factor in more recent mutualisation figures into our impact assessment going forward.

- An attendee queried how this proposal would contribute to net zero and innovation goals. Our primary aim is to reduce the scale of costs at risk of mutualisation when a supplier fails and ensure suppliers bear the cost of their own risk. This should result in a financially sustainable market where suppliers are better able to invest in the research and development and innovation required to enable the retail market to play a key role in achieving net zero.

<u>Other questions</u>

- Suppliers asked how retrospective application of the policy, to address pre-existing surplus credit balances in the market, would be handled. We stated that this was a question on implementation and that we were keen to hear views from stakeholders on what an appropriate implementation approach would be.

- Suppliers asked if there is a risk that customers move away from fixed direct debits (or suppliers stop offering fixed direct debits) onto variable or quarterly tariffs. Our consultation sets out that our proposals ensure that the level of credit required to operate a fixed direct debit model is preserved. We outline our thoughts on this in the cost/benefit appendix of our consultation.

Breakout session 1 – Threshold model

The questions we asked attendees were:

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?

The two most commonly expressed concerns around the threshold proposal were its lack of flexibility (in terms of the threshold limits and the variability of energy consumption) and the difficulty for suppliers to forecast energy consumption for the year ahead to prepare protections for surplus credit. To address these concerns, suppliers recommended a level of tolerance should be built into the threshold.

Sudden shocks to demand, such as an extreme weather event, or other macro-scale events such as the Covid-19 pandemic were given as examples. Suppliers recommended speaking with Elexon and Xoserve to understand how they account for variables such as the weather.

One supplier highlighted the incompatibility of the model in its current form with gas-only suppliers. Gas consumption is proportionately higher in winter and lower in summer compared to electricity – they argued that the model in its current form aligns closer to electricity consumption patterns. A different threshold for each fuel type was suggested.

Suppliers also questioned our assumption that customers join suppliers at an equal rate across the year, which informed our threshold’s design.

Breakout session 2 – Implementation of proposals

The question we asked attendees was:

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

Views on the length of time required to comply with our policy proposals varied. In general, larger suppliers argued for shorter implementation timeframes, typically around a year, though as short as six months in one case. Small and mid-sized suppliers argued for longer timeframes primarily due to the length of time it would take to secure new funding to replace the surplus credit balances they previously would have had access to – as long as five years. These suppliers also expressed concerns around their ability to raise sufficient investment (particularly if all suppliers were to seek funding from investors at the same time). Multiple suppliers predicted a high chance of small supplier failures (and increased credit balance mutualisation) as a result of the policy.

Smaller suppliers also stated that, although they could plan, until a decision is published they would not be able to take definitive action.

Suppliers overall agreed that implementation of the threshold would take less time than the autorefund policy and some argued that they do not need to be implemented together.

Other points raised included:

- That the autorefund should be set to allow for one or two month's worth of credit to roll over
- Timings should align with smart meter roll out and avoid conflicts with faster switching arrangements
- RO reform needs to happen in parallel

Breakout session 3 – Costs & benefits of the proposals

The questions we asked attendees were:

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

Overall, the discussion focused on the costs of the proposals. As noted above in the implementation breakout summary, smaller suppliers argued that the proposal would favour large suppliers due to working capital being more readily avialble to them and, in the worst case, likely to lead to smaller suppliers failing. If this were to happen, then credit balance mutualisation costs could increase in the year following the policy's introduction. Attendees argued that due to the high costs smaller suppliers would face, tariff prices would increase and consumer choice decrease as a result of the proposal and that this should be accounted for in the impact assessment.

A number of suppliers stated that a range of operational costs needed to be factored in, including:

- System development costs from implementing the changes required, particularly for autorefund
- People costs from potentially increased complaints from those who did not want an automatic refund or who got an autorefund but whose direct debit increased due to tariff rises or increased consumption
- Costs arising from changing customer journey communications (sign-up, direct debit reviews etc)
- Larger suppliers spoke of the costs associated with obtaining guarantees.

Suppliers considered that the operational cost of processing and issuing autorefunds would be negligible.

Some attendees also suggested that the policy could be gamed or exploited by customers, such as through referring a friend to a supplier for bonus referral credit, then changing supplier and having the credit refunded or through consumers deliberately underestimating their consumption.

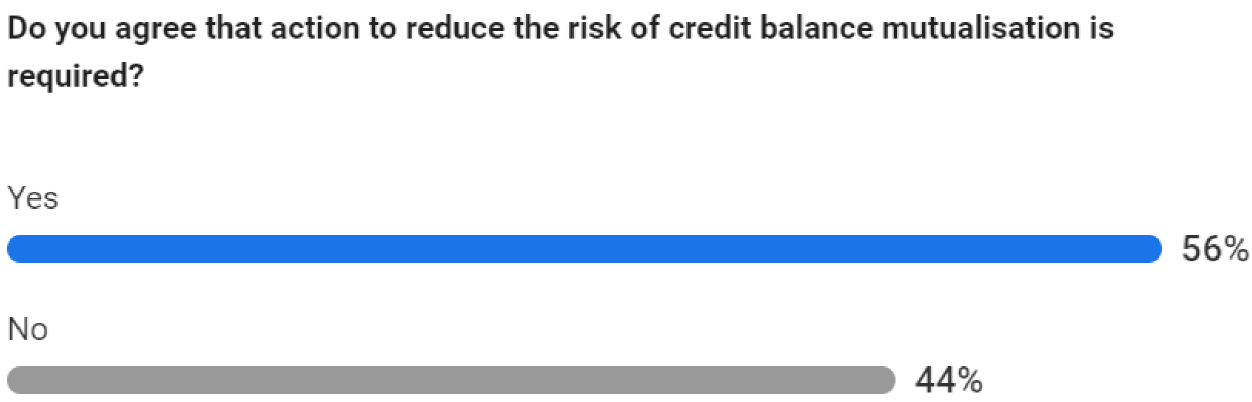
Some attendees called for Ofgem to rerun the Request for Information issued in 2020 on 2018 credit balances and use this to update both the level of surplus credit balances in the market and reported costs/benefits.

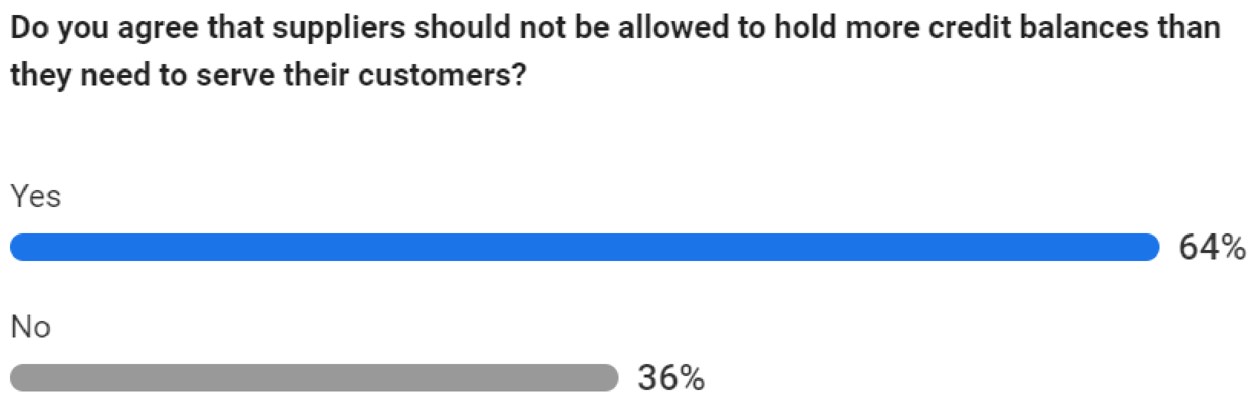
Appendix 1 – Attendees

British Gas	Energy UK	Ombudsman Services	Together Energy
Bulb	ESB	OVO Energy	Utilita
Centrica	ESG	People's Energy	Utility Warehouse
Citizens Advice	FESL	Pozitive Energy	Zog Energy
Cornwall Insight	Good Energy	Pure Planet	
E (Gas & Electricity) Ltd	Green Energy	Scottish Power	
E.ON	Igloo Energy	Shell Energy Retail	
EDF	Octopus	So Energy	

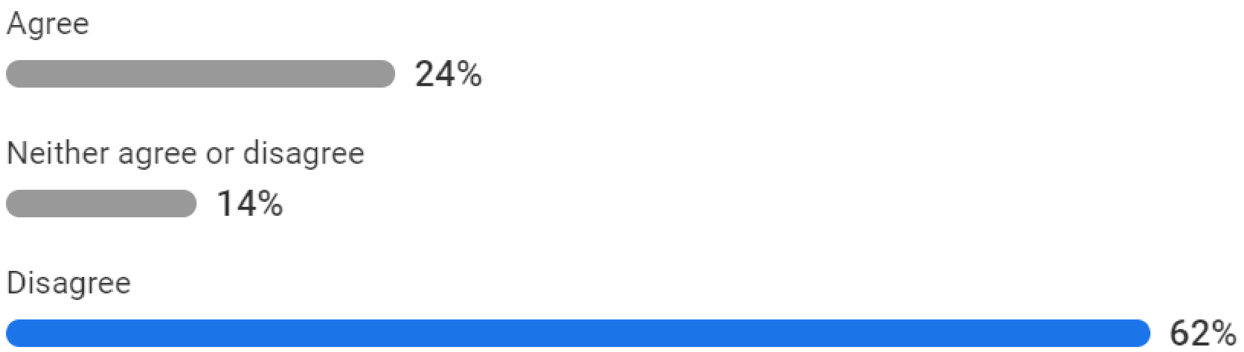
Appendix 2 – live poll results

Pre-discussion poll results:



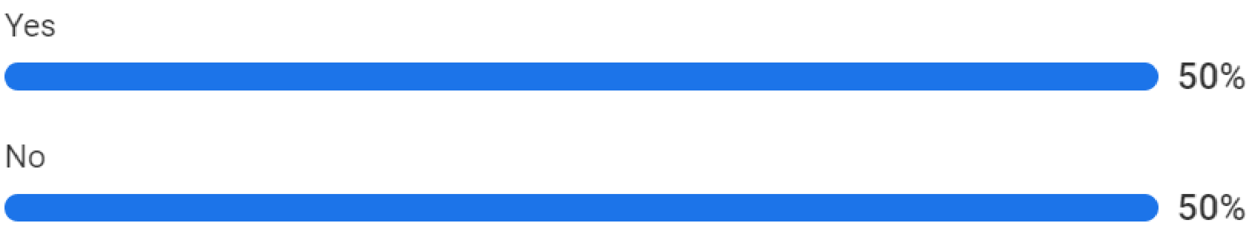


Do you agree that our proposals are a proportionate way to limit credit balance mutualisation?



Post-discussion poll results:

Do you agree that action to reduce the risk of credit balance mutualisation is required?



Do you agree that suppliers should not be allowed to hold more credit balances than they need to serve their customers?

Do you agree that our proposals are a proportionate way to limit credit balance mutualisation?