Making a positive difference for energy consumers

Personal Projection: Updated thinking on the way forward

Working Paper

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Overview:

We are seeing increasing innovation in the types of tariffs that are offered to domestic consumers following the removal of rules restricting their number and structure. This is likely to continue, and accelerate, in future as smart meters enable increasingly dynamic and tailored tariffs. We want to make sure that domestic consumers have the necessary tools to be able to understand their current circumstances, budget effectively and to compare their current tariff with others – and that these tools remain fit-for-purpose as the market evolves.

Building on our enforceable Standards of Conduct and new 'informed choices' principles, we are now reviewing the methodology for estimating consumers' annual costs (the Personal Projection) to make sure that it supports, not constrains, innovation. We want to establish a framework within which suppliers and comparison sites have room to adapt the projection to consumer preferences and innovative tariffs, while putting in place controls to ensure consumers are not misled and are able to make good decisions about the tariff that is most appropriate to their circumstances.

This paper sets out our latest thinking on how we might build on the existing principles and amend the Personal Projection rules so they remain fit-for-purpose in a rapidly changing market.

Introduction

1.1. We want to make sure that domestic consumers have the necessary tools to be able to understand their current circumstances, budget effectively and to compare their current tariff with others. As part of this, we want consumers to be provided by suppliers and price comparison websites with an estimate of their annual costs that is personalised and transparent. We want consumers to be able to understand what the estimate is and what it can be used for. We also want it made clear to consumers what assumptions have been built into it, so that they can understand how their behaviour might affect their bill.

1.2. We are committed to relying more on enforceable principles in the way we regulate the retail energy market, rather than detailed, prescriptive rules. We believe this approach will better protect consumers in a rapidly evolving market, promote innovation and place responsibility firmly on suppliers to understand and deliver positive outcomes for consumers. We want to amend the Personal Projection rules in alignment with this broader direction of travel. We want the new approach to build on the overarching principles set out in the Standards of Conduct of the supply licence, and the 'informed choices' principles we introduced recently.[1]

1.3. This paper explains our intention to replace the current prescriptive methodology for estimating the annual cost of a tariff with a set of principles for suppliers and Confidence Code-accredited price comparison websites to provide a personalised and transparent projection of annual costs. This requirement would be supported by specific controls for the treatment of discounts, bundles and assumptions relating to expected changes in consumer behaviour.

1.4. We want any approach we put in place to be future-proofed and capable of keeping pace with new tariffs that come to market. We want to leave sufficient room for it to be tailored to consumer preferences, and for suppliers to innovate in terms of the additional information they provide to consumers – for example, as this relates to innovative time of use or demand-side response tariffs. The new approach should also have controls in place so that consumers are not misled about how much they are likely to pay or save on a given tariff.

1.5. Currently, suppliers must follow a prescriptive methodology set out in our supply licence conditions.[2] This methodology applies only to domestic consumers. Price comparison websites accredited under our Confidence Code are also required to use the same methodology.

1.6. The existing methodology needs updating to reflect the wider range of tariffs that may come to market following the recommendation of the Competition and Markets Authority (CMA) to remove restrictions on the number and structure of

[1] Ofgem, Final Decision: Enabling consumers to make informed choices, April 2017
[2] The current definition of Estimated Annual Cost is set out in annex 1 to this document.

tariffs and discounts. After consulting with stakeholders we removed these restrictions in November 2016.[3]

1.7. Following consideration of the impact of the changes to the tariff rules, in August 2016 we proposed to replace the current prescriptive Personal Projection methodology with a set of narrow principles.[4] We followed this consultation with a workshop in November.

1.8. Stakeholder feedback to the consultation and at the workshop acknowledged the challenges with the current approach. Almost all stakeholders felt that suppliers and comparison sites should have some flexibility in how they estimate costs as long as the calculation is transparent for consumers. A majority of respondents supported an approach that was the same within each individual supplier or comparison site. However, others felt this did not go far enough, and wanted a methodology that was identical across the entire industry. There were notable differences of opinion between suppliers and comparison sites – in general the former supported greater flexibility whereas the latter were more in favour of a prescriptive approach.

1.9. There are a number of ways of calculating an estimate of annual costs, each of which may be appropriate in different situations. There may not, therefore, be a single approach suitable for all contexts. The current, one-size-fits-all methodology is likely to be unsustainable in the context of increasing tariff innovation, so a principles-based approach may deliver better outcomes for consumers.

1.10. This paper builds on our earlier consultation, setting out in greater detail how we intend to give suppliers and comparison sites more freedom to develop their own ways to calculate a domestic consumer's estimated annual cost on a given tariff. We have considered the feedback stakeholders have provided to date[5], and are currently intending to move forward with the position set out in this paper.

1.11. We will use this document to inform discussions with stakeholders and develop formal proposals for a statutory consultation in summer. We do not expect stakeholders to respond formally to this working paper. If there are particular views you would like to share with us, please do so via the following email address: futureretailregulation@ofgem.gov.uk

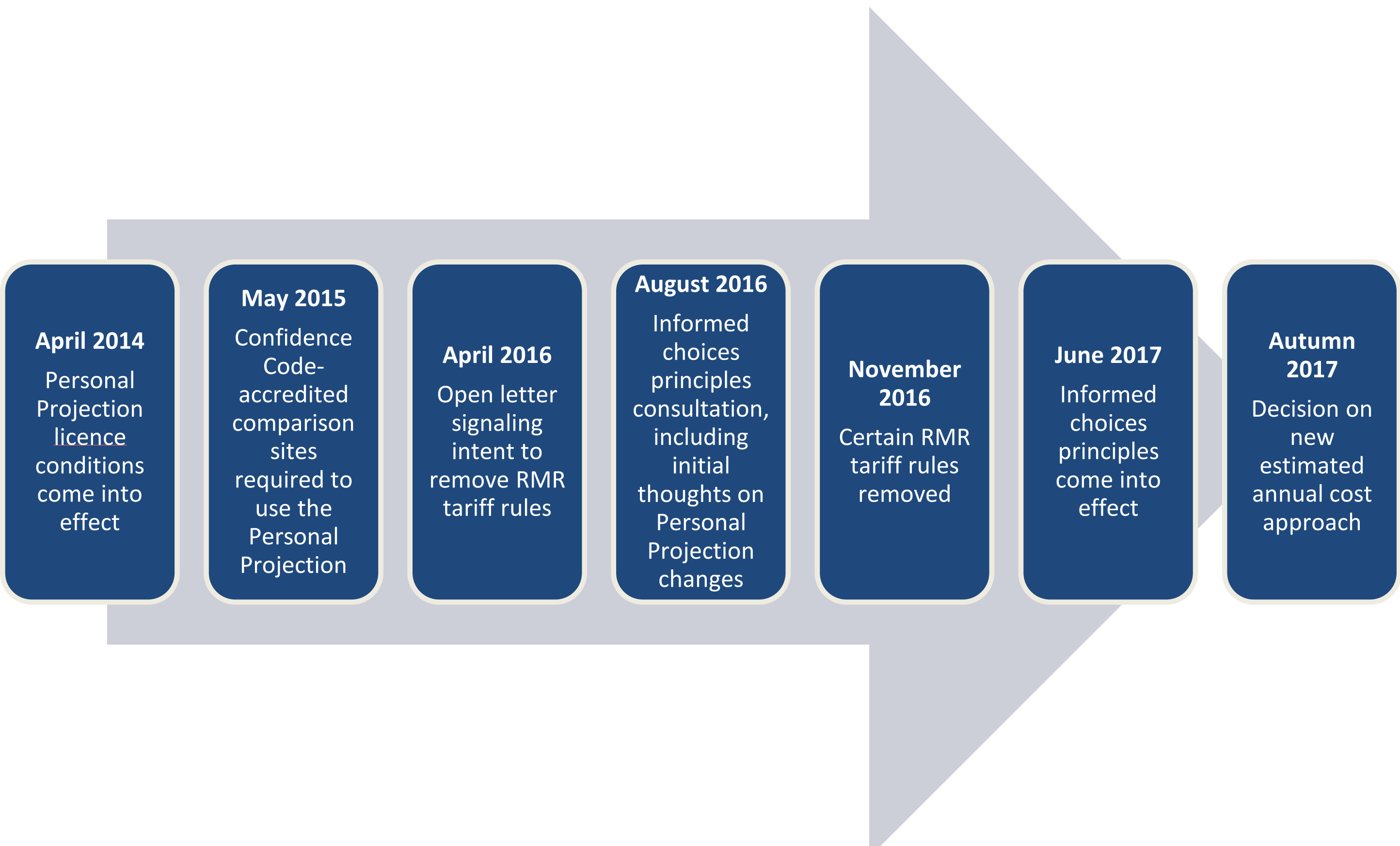
Background

1.12. In 2014, we introduced the 'Personal Projection' – a tool for domestic consumers to understand how much they are paying for their energy and to enable them to compare their deal with others on the market. This was part of our Retail

[3] Ofgem, Modification of electricity and gas supply licences to remove certain RMR Simpler Tariff Choices rules, September 2016
[4] Ofgem, Helping consumers make informed choices – proposed changes to rules around tariff comparability and marketing, August 2016
[5] A summary of the feedback to the August consultation is included at annex 2.

Market Review (RMR) reforms for the retail energy market.[6] It replaced a high-level requirement for suppliers to provide an illustrative projection of annual costs to each consumer.[7] The Personal Projection is a prescriptive methodology, set out in standard supply licence condition 1 under 'Estimated Annual Cost', for suppliers to use to calculate the cost a consumer would pay on a given tariff.[8] It was introduced to give consumers a means of comparing their tariff with others, and to make it easier for them to budget. It sets out in detail how we expect suppliers to factor unit rates, standing charges and different types of discounts and bundled products into an annual cost calculation.

Figure 1: Timeline of changes relating to the Personal Projection



[6] Ofgem, [Retail Market Review – Statutory consultation on the RMR domestic proposals](), June 2013
[7] Prior to the introduction of the Personal Projection, suppliers were required to provide consumers with "an illustrative projection of the costs in pounds sterling of the quantity of [electricity/gas] supplied to the [consumer] for the forthcoming 12 months assuming those premises are supplied with the same quantity of [electricity/gas] as during the previous 12 months."
[8] Gas and Electricity Markets Authority, [Standard conditions of electricity supply licence](), Consolidated to 01 April 2017

Current rules

1.13. The Personal Projection is based on a consumer's actual consumption (or a best estimate of their consumption if actual readings are not available), and includes the unit rates, standing charge, and non-contingent discounts and charges for bundled products associated with a given tariff. Domestic suppliers are required to consistently name it the 'Personal Projection' when providing it to consumers (eg on energy bills), and to accompany the figure with a description of what charges and discounts it includes.

1.14. We subsequently changed our Confidence Code, a voluntary code of practice for domestic energy price comparison websites, to require accredited sites to use the Personal Projection methodology, as a default, when comparing the price of different tariffs. Accredited sites had previously been required to follow Code rules setting out the types of discounts and charges that should be included and excluded from the calculation. We made this change in order to provide consumers with a degree of consistency in the tariff prices they see in different forums. We allowed accredited sites to provide different methodologies should they choose, but required that they use the Personal Projection as the default means of calculating the price of different tariffs.

1.15. Several sites have expressed concerns about the current methodology, arguing that some of the assumptions used for the purposes of the calculation about consumer behaviour at the end of fixed-term tariffs do not align with what their users expect to see, or how they often behave in practice.

1.16. Following its energy market investigation, the CMA recommended that we remove the prescriptive tariff rules (introduced to the supply licence as part of the RMR reforms) to allow greater room for innovation.[9] After consulting with stakeholders we removed the RMR tariff rules in November 2016.

1.17. Our existing Standards of Conduct, and the informed choices principles that came into effect recently, ensure that consumers are treated fairly, that the information provided to consumers must not mislead them, and should enable them to compare and select appropriate tariffs. We intend that any revised approach for calculating estimated annual costs will build on these principles, while avoiding unnecessary duplication.

Reviewing the Personal Projection methodology

1.18. There are a few key drivers for considering changes to the Personal Projection rules. These are:

[9] CMA, Energy market investigation: Final report, June 2016

- The current prescriptive approach has become outdated and unsuited to some new tariffs and discounts due to changes in other market rules;
- Consumer awareness and use of the Personal Projection is relatively low; and
- The one-size-fits-all assumptions built into the current methodology may not be what consumers expect or want to see.

New tariffs and discounts

1.19. When removing the RMR tariff rules, we highlighted the need to adapt the Personal Projection to the new categories of tariff or discount that could now be offered to consumers. For instance, the letter of the Personal Projection requirements does not specify how percentage discounts should be included in the calculation.[10] We have already seen new types of tariffs start to come to market – for example 'tracker' tariffs whose price is benchmarked against an independent index – in future tariffs may appear that are not compatible with the current methodology.

1.20. To allow us to deliver the CMA changes as quickly as possible, we chose to implement the tariff changes first, and to deliver any consequential amendments to information requirements (such as the Personal Projection and the Tariff Information Label) later. In the meantime, we made clear our expectation that if suppliers wanted to offer tariffs that were not fully compatible with existing information requirements we would expect them to adapt their approach to complying with these rules to ensure consumers "continue to receive appropriate prompts to engage, are not misled and are able to make properly informed decisions."[11]

Consumer awareness and use of the Personal Projection

1.21. Since its introduction in 2014, consumer awareness and use of the Personal Projection has been relatively low – approximately 30-35% of consumers can recall seeing one. Of these, a minority (32% in 2016) were prompted to take any action, such as comparing their tariff with others on the market, upon seeing a Personal Projection. This indicates the Personal Projection has not had the impact we may have expected for consumers – either in their awareness or use of it. Allowing suppliers and comparison sites greater room to innovate and tailor the Personal Projection to consumer preferences may, therefore, provide scope for more effective prompts.

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[10] Percentage discounts are those discounts that reduce a consumer's overall price by a percentage. Other discounts can be based on a lower unit rate or on a per day reduction in costs.
[11] Ofgem, CMA provisional remedies: removal of certain RMR 'simpler choices' rules, April 2016

Calculation assumptions and consumer expectations

1.22. The Personal Projection assumes that the consumer takes no action to switch over the following 12 months from the date of calculation. This means that if a consumer is on a fixed-term tariff with, say, three months remaining, the calculation will assume that at the end of the fixed term they will default onto the relevant cheapest standard variable tariff. However, this assumption does not reflect all consumer behaviour – many customers make an active choice to switch at the end of their existing fixed term and may be confused when presented with a calculation that is based in part on the a default set of standard variable tariff rates.

Consultation to date

1.23. In August 2016, we consulted on enduring changes to the Personal Projection. We proposed to retain the requirement for suppliers and price comparison sites to provide an estimate of annual costs and to amend the definition of Estimated Annual Costs to remove the prescriptive formula. In doing so, we proposed to allow suppliers and comparison sites to develop their own methodologies for estimating annual tariff costs. This flexibility would be subject to principles that the calculation be internally consistent, personalised, transparent, fair and as accurate as possible, and based on reasonable assumptions and all available data. In November, we held a workshop with stakeholders to obtain further views.

1.24. The vast majority of stakeholders (both consultation respondents and workshop attendees) supported giving suppliers some flexibility to make different assumptions or use different methodologies when generating an estimated annual cost figure. They felt this flexibility would be particularly useful for time-of-use tariffs, tariffs whose value is dependent on behavioural change by the consumer, or tariffs with a duration of less than a year.

1.25. A majority of stakeholders (including both suppliers and comparison sites) supported an estimated annual cost figure that is calculated in an internally consistent way – eg in a way that is consistent within a supplier's own tariffs or for all tariffs on a price comparison site. However, some felt this was not sufficient and that consumers would be confused unless there was a prescriptive approach across the entire market.

1.26. Most stakeholders supported the principles for the calculation to be internally consistent, personalised and transparent, though some questioned whether the requirements for the projection to be 'as accurate as possible' and based on 'all available data' would be proportionate in all circumstances. Other stakeholders raised concerns that this type of principles-based requirement would make it difficult for price comparison sites to compare results across suppliers, and advocated a more prescriptive approach.

1.27. Some stakeholders suggested specific alternatives to our proposal, including to introduce a 'primary default view' for the estimated annual cost – this would be calculated using actual consumption where available (or an estimate where not) and would exclude all one-off discounts, bundles or loyalty offers. Consumers would then have the option of separately viewing a version of the estimated cost including any discounts or bundles.

1.28. Given the range of views received both in response to the consultation, and at the stakeholder workshop, we decided to give further consideration to the options for reforming the estimated annual cost approach before proceeding with our consultation process. Below we share our updated thinking on the issues and challenges, the options for reform, and our current thinking on the way forward.

Policy issues and considerations

1.29. There are a number of key issues we have considered as part of our work to redesign the Personal Projection. We summarise these briefly below.

Level of prescription

1.30. Adopting a prescriptive approach facilitates more consistent results across the industry as parties are constrained in their ability to make different assumptions. This means that consumers are more likely to see similar or identical results when they view their estimated annual cost on different comparison websites or from different suppliers. But such prescription may mean that consumers get an estimate of their costs that doesn't reflect their expected behaviour (eg if they plan to switch at the end of a fixed-term tariff) and stifle the ability of suppliers and comparison sites to develop better ways of estimating costs.

1.31. Principles allow room for this innovation. They also leave greater space to tailor an approach to suit new types of tariffs and to present costs in a way that meets an individual consumer's preferences. Allowing too much flexibility may leave the new approach exposed to the risk of gaming by suppliers and others, using a version of a consumer's estimated annual cost to confuse or mislead them.

1.32. Through our existing Standards of Conduct, and the informed choices rules we introduced recently, we have already put in place enforceable principles that will help to ensure that suppliers treat consumers fairly and are provided with the information they need to make the right choice for them. We want to supplement these existing general principles with specific rules to make sure consumers are provided with accurate and transparent estimates of their annual costs.

Consumption assumptions

1.33. We want cost projections to be based on the best possible estimate of a consumer's usage, where actual readings are not available or where there are only partial readings. Consumer take-up of time of use or demand-side response tariffs is an important part of the move to a more flexible energy system. Consumers may have to adapt their behaviour or consumption patterns to get maximum value from these types of tariffs. We want to make sure that the potential benefits of these tariffs can be communicated to consumers, while ensuring that assumptions about consumers' behaviour change are not used to mislead them as to the savings they could make.

Treatment of different types of discounts

1.34. The methodology currently excludes one-off and 'contingent' discounts (those discounts that a consumer has to behave a certain way to receive, eg prompt pay) and includes other 'non-contingent' discounts (eg online or dual fuel discounts). The methodology also specifies how discounts should be factored into the calculation of costs when they are accrued either over time or on a per kWh basis. However, this doesn't currently cover discounts that might be accrued in other ways, such as a percentage discounts. These types of discounts were previously banned but can now be offered to consumers following the removal of certain RMR tariff restrictions.

1.35. We want to create room for these new types of discounts to be included within the approach to the calculation. We also want to make sure that where certain types of discount are contingent on a consumer behaving a certain way (eg submitting meter readings, paying on time) that this is transparent to the consumer and the projection does not mislead them as to the cost they will pay.

Treatment of bundled products

1.36. Energy tariffs can be 'bundled' with other products or services such as boiler care cover, shopping reward points, smart thermostats or other utilities. At present, where these are optional (ie you don't have to take the bundled product or service to get the energy tariff) the costs are excluded from cost projections. Where they are 'tied' (ie you must take the additional product or service to avail yourself of the tariff) the costs are included wherever these can be monetised. As with discounts, we want to make sure that where charges for bundled products or services are optional or mandatory that this is made clear to the consumer, and they are not presented with an unrealistic expectation of what their bill will be on a given tariff.

Assumptions at the end of a fixed term

1.37. The projection currently assumes that at the end of a fixed term a consumer will take no action and by default will roll onto the relevant cheapest standard variable tariff. This is in line with what will currently happen in practice should a consumer not switch at the end of their fixed term. We are separately considering whether this policy should be adjusted, to enable suppliers to automatically roll consumers onto different types of tariffs, subject to certain protections.

1.38. Even without this policy change, we recognise that certain consumers may feel that a projection that assumes they will roll onto another tariff is confusing. Such consumers may, for instance, prefer a projection that represents an annual total of their current tariff's rates. We want to allow room for this. We consider that existing communications, such as the end of fixed term notice, already provide useful information to consumers about the impact to them should they choose not to switch at the end of an existing fixed term. This means we may not need to specify the assumptions that should be made about a consumer's behaviour at the end of a fixed-term tariff.

Name and description of the estimated annual cost

1.39. Suppliers and Confidence Code-accredited comparison sites are currently required to refer to the estimated annual cost as the 'Personal Projection' wherever they provide it to consumers. The projection must also be accompanied by a description of what is included in it. If we allow suppliers and comparison sites to come up with their own methodologies a consistent name may no longer be appropriate, as consumers might believe they are seeing consistently-calculated projections when they may not be. We would expect that any name used to describe the projection by suppliers and comparison sites would not be misleading for consumers.

1.40. The description of the estimated annual cost will continue to be important to help consumers understand the assumptions that are made in its calculation – this is particularly the case if the figure can be calculated in different ways. We want to enhance these descriptions to ensure that consumers are aware of what the estimated annual cost is, what it can be used for, and the assumptions that have been made in its calculation.

Avoiding 'gaming'

1.41. Giving suppliers and comparison sites more flexibility over which approach to use may incentivise them to choose a way of calculating the costs of tariffs that either maximises or minimises the savings (depending on their objective). In line with the overarching principle for suppliers to treat customers fairly, we want to make sure that where the projection is used for the purposes of comparing tariffs, this comparison is made on a like-for-like basis – so any assumptions used to calculate the cost for one tariff should also apply to others within a supplier's portfolio or for all tariffs on a price comparison site.

Period covered by the projection

1.42. The projection is currently always an annual figure. Consumers may have different preferences for the period to be covered by their cost projections. We intend to continue to require the projections to be annual as a default, to ensure that prompts such as the cheapest tariff message continue to be as impactful as possible. However, we may choose to revisit this requirement in future depending on the outcome of our work to support the trialling of prompts for consumers to engage.

Use of the methodology by suppliers and price comparison websites

1.43. As noted above, at present the Confidence Code requires accredited sites to use the Personal Projection as a default when calculating the cost of different tariffs. We felt that such a requirement was sensible as price comparison websites, as 'representatives' of suppliers in certain contexts, may be subject to the licence requirements to provide a Personal Projection anyway. We thus amended the Code in order to avoid ambiguity, and to minimise the risk that inconsistent methodologies could be used by accredited sites to compare tariffs. We consider that arguments to allow greater flexibility for suppliers to innovate in how they calculate cost estimates apply equally to comparison sites, and so we intend to apply the same requirements to accredited sites and suppliers. Our intention is to consult on revised Code drafting at the same time as we issue a statutory consultation for changes to the licence.

Options

1.44. We have considered a number of options for reforming the current approach to estimating the annual cost of tariffs. These are set out below.

Option 1: Retain prescriptive methodology

1.45. We would make adjustments to the existing methodology to reflect the removal of restrictions on percentage discounts following the CMA's recommendations. We would not make any further proactive changes to the methodology but would monitor market developments to assess whether further changes were warranted in future.

1.46. This change would quickly address one gap in the existing methodology that we are aware of. It would have minimal knock-on effects on other licence conditions and would not be a significant change from the information already provided by suppliers and comparison sites, and so we would expect that it would be relatively straightforward to implement. As the prescriptive conditions would remain, we would provide a measure of cross-market comparability.

1.47. However, this change is not likely to be sustainable. The prescriptive conditions would remain, meaning the new approach may require constant updating to keep pace with tariff innovations or policy developments (eg regarding automatic rollovers at the end of fixed-term tariffs). This may slow down or impede suppliers and comparison sites providing better cost projections to consumers, stop some innovation happening and may lead to more calls for derogations from our rules.

1.48. Even maintaining our current approach would not provide cross-market comparability across all tariffs. For time of use or demand-side response tariffs the time of day and time of year a consumer uses their energy becomes more important to the overall cost they will pay. We do not tell suppliers which to take into account when estimating consumer usage, so there is always likely to be some variation in the results a consumer sees for such tariffs.

1.49. This option would not, therefore, provide identical results as desired by some stakeholders. At the same time, it would not address concerns from comparison sites that it does not reflect consumers' expectations or actual behaviour at the end of their fixed-term tariffs.

1.50. We think that any benefits that this option brings in comparability across the market are outweighed by the restrictions it may place on suppliers' ability to develop improved methodologies. It is also unlikely to deliver the best consumer outcome as it makes one-size-fits-all assumptions that may not be appropriate to all, while stifling suppliers' and comparison sites' ability to develop more accurate and engaging means of estimating costs.

Option 2: Revert to pre-RMR requirements

1.51. Under this option, we would remove the definition of Estimated Annual Cost from the licence and revert to the pre-existing requirement for suppliers to provide "an illustrative projection of the costs in pounds sterling of the quantity of [electricity/gas] supplied to the [consumer] for the forthcoming 12 months assuming those premises are supplied with the same quantity of [electricity/gas] as during the previous 12 months."

1.52. This option has the benefit of moving to an approach that at least part of the industry is familiar with, having produced it for consumers in the past. It would give substantial flexibility to suppliers and comparison sites to develop their own methodologies to reflect their tariff offerings.

1.53. We know from experience that this formulation can be problematic. Part of the reason for creating the current methodology was to prevent some of the varying practices that were adopted around the industry. These included differing approaches to the inclusion of certain discounts, and the provision of heavily caveated statements to consumers describing what *may* or *could be* included in the cost projections.

1.54. Although most stakeholders supported allowing a degree of flexibility to suppliers and comparisons sites in how they calculate annual costs, this option goes beyond what the vast majority of stakeholders supported.

1.55. We consider that returning to this formulation carries a major risk that consumers will find it difficult to determine their likely costs on a given tariff. Suppliers and comparison sites could each have different ways of treating discounts, or their own assumptions about what a consumer's consumption pattern is likely to be on a given tariff, which may make it difficult for consumers to ascertain what their 'default' cost is likely to be.

Option 3: Narrow principles

1.56. Under this option we would replace the existing detailed definition of Estimated Annual Cost with a shorter, principles-based definition that requires suppliers and price comparison sites to provide a projection of annual costs that:

- Is personalised to the consumer, based on all data that is reasonably available to the supplier or price comparison site, and reasonable assumptions where actual data is not available;

- Does not assume, as a default, that a consumer's behaviour, or consumption levels or patterns will change;
- When used for comparisons, is internally consistent (or like-for-like), such that the same assumptions, where relevant, should be made for all tariffs that are being compared; and
- Is transparent, and accompanied by a name and description for the projection that makes clear to the consumer what it is, what it can be used for, and any assumptions that have been used in its calculation.

1.57. Under this option we would expect that the estimated annual cost calculations would not automatically assume that the consumer can or will change their behaviour. It would, however, enable suppliers or comparison sites to provide consumers with additional messages to show how behaviour change could affect their bills.

1.58. This option would retain the current general approach to the inclusion of discounts in the projection – namely excluding contingent and one-off discounts, and including non-contingent discounts. This would mean that consumers would be provided, as a default, with an estimate of their annual costs that does not take into account any discounts they would have to behave a certain way to obtain. Similarly, we would retain the current approach to the treatment of charges for bundled products or services. Where these charges are optional then they should be excluded from the calculation. Non-optional costs for bundled products or services should be included in the estimate wherever these can be monetised.

1.59. This option has the benefit of providing a basic set of assumptions, eg in the treatment of discounts, where we know that there are certain practices we would not want as a default. At the same time, it does not prevent suppliers or comparison sites from using additional messages or functionality where they want to convey the potential benefits of a tariff to consumers. For instance, they could provide additional savings messages or include applications that allow a consumer to adjust the calculation assumptions to reflect the cost they would pay should they change consumption level or patterns. In providing this flexibility, it avoids recreating the recently-removed tariff design constraints by another means. We already require suppliers and Confidence Code-accredited comparison sites to provide supporting information to consumers, including, for instance, the Tariff Information Label. We would expect these existing requirements to provide backstop protections for consumers.

1.60. As there is a degree of flexibility in this approach, it does not necessarily provide for cross-market comparability. This may mean that the results a consumer sees are not identical across different channels. This could, for example, mean a consumer receives a different total cost from different suppliers if one continue to use the current methodology and another chooses to use a new approach.

1.61. This option would not, therefore, provide identical results across the whole market, which is what a minority stakeholders have sought. However, it will provide consumers with a projection that is based on a transparent and reasonable set of assumptions about their current behaviour, and should ensure that they are not misled about how much they are likely to pay on a given tariff. We think this, combined with stronger naming and description requirements should help consumers to understand what the projection is based on and why there may be differences between those from different sources.

Option 4: Mixed methodologies

1.62. Under this option we would apply a prescriptive methodology, similar to that outlined under option 1, to certain 'basic' tariffs such as standard variable and fixed term, fixed rate tariffs, and allow suppliers flexibility to develop their own methodologies for more complex tariffs.

1.63. This has the benefit of providing some consistency of cost calculation across the most common types of tariffs while giving suppliers space to develop bespoke methodologies for more innovative tariffs. However, we have seen that even for 'simple' tariffs there can be disagreement among stakeholders about the best way to calculate costs, eg regarding assumptions about what a consumer will do at the end of their existing fixed-term tariff.

1.64. The potential negative consequence to this is that it may be confusing for consumers if they were to receive several price projections for different tariffs, each with their own sets of assumptions attached. This may make consumers less confident in their ability to make the 'right' decision and lead them to disengage.

Related areas

1.65. The estimated annual cost is an important piece of information for consumers in its own right. It is also the basis for other prompts to consumers, and links closely with a number of other policy areas. These are set out below. We have considered these areas in developing our current position, and we will continue to ensure these links and dependencies are managed as we progress this work.

Confidence Code

1.66. As noted above, Confidence Code-accredited comparison sites are required to use the Personal Projection as the default basis for comparing tariffs. We consider that the arguments in favour of allowing suppliers greater flexibility to determine how they calculate consumers' estimated annual costs apply equally in the case of comparison sites. We intend that any changes we make to the licence requirements would also apply to the Confidence Code. The Code requirements refer to the definition of Estimated Annual Cost as set out in the licence conditions. A licence change may therefore, in effect, result in a Code change. As noted above, we do not want to adopt a different set of requirements for the licence and the Code. We intend to manage the changes to both in tandem. We welcome views from price comparison sites on the content of this working paper. We intend to issue revised Code drafting at the same time we publish suggested licence text, when we issue our statutory consultation later in the summer. We will provide an overview of how we intend to manage implementation dates for Code and licence changes at that stage.

1.67. Separately, the CMA is conducting a market study on digital comparison tools, including price comparison websites. We will continue to monitor this work and consider whether their findings have any implications for our policy design. We expect that the changes we are making to estimated annual cost calculations will be beneficial, in conjunction with any recommendations the CMA may make.

Cheapest tariff message and prompts to engage

1.68. The cheapest tariff message tells consumers how much they could save by moving to a cheaper tariff with their current supplier. It is included on a number of supplier communications, including bills and annual summaries. The savings calculation is based on the Personal Projection methodology. Providing for an approach that is consistent within each individual supplier's portfolio is key to ensuring cheapest tariff message to function as intended.

1.69. Separately, we are currently working with the industry to trial different prompts to encourage consumers to engage. The estimated annual cost is likely to be an important input for our work in this space.

Customer communications

1.70. As part of our move to rely more on principles, we are working with the industry to reduce the prescription of the rules for customer communications such as bills, annual summaries, and price increase notifications. The Personal Projection is an important piece of content on these communications. This working paper's scope is focused on the Personal Projection methodology, name and description. The customer communications work will consider a broader range of issues, and may revise requirements, eg relating to the placement of the Personal Projection on customer communications.

Half-hourly settlement, the smart meter rollout and tariff innovation

1.71. The rollout of smart meters and the move to half-hourly settlement of consumers will lay the groundwork for more innovative tariffs to come to market, including time of use or demand-side response tariffs. These tariffs may place greater emphasis on consumers having reliable estimates of what they are likely to pay to hand to ensure they can choose the right deal for them. It will, therefore, be important to have appropriate protections in place while also ensuring the new approach is flexible enough to deal with these new and innovative tariffs.

Automatic rollovers

1.72. We are considering whether to change the requirement for suppliers, as a default, to roll consumers onto the relevant cheapest standard variable tariff at the end of a fixed term tariff. We sought early views on this last year and intend to take this forward for further consultation in the summer. Any change to this policy could have an impact on the assumptions that could be used to estimate a consumer's annual costs.

Thoughts on way forward

1.73. Our thinking at this point is that we pursue option 3: narrow principles.

1.74. We have carefully considered the feedback we have received in response to consultations, both the recent policy consultation and workshop and submissions to previous consultation processes. This feedback has helped us to build on the proposals we set out last year.

1.75. We consider the current prescriptive methodology is unlikely to deliver the best outcomes for consumers either now or in future. Our recommended option builds on the groundwork we have put in place through the introduction of the informed choices principles. It provides flexibility for suppliers and comparison sites to develop their own methodologies, placing the emphasis firmly on them to deliver in the consumers' interests. It should also provide better protection for consumers – by defining a set of principles, rather than a prescriptive formula, we want suppliers and comparison sites to follow this should mean that the estimate is future-proofed and capable of being adapted to consumer preferences and expectations. The recommended approach should also help to support, rather than constrain, tariff innovation.

Next steps

1.76. We are continuing to develop our proposals for our upcoming statutory consultation on Personal Projections in summer. In that consultation, we will expand on the issues and suggested way forward covered in this paper, in conjunction with any further views we receive from stakeholders.

1.77. Our intention is that we issue the statutory consultation and consider responses in time to issue a decision in autumn.

1.78. We look forward to engaging with stakeholders throughout this period, and welcome any views on this working paper as our thinking progresses. Please get in touch with futureretailregulation@ofgem.gov.uk if you would like to share your thoughts or arrange to discuss with us.

Annex 1: Definition of Estimated Annual Cost as set out in the electricity and gas standard supply licence

Estimated Annual Costs means the total amount in pounds sterling (inclusive of value added tax) based on the following calculation (or a mathematical equivalent):

Estimated Annual Costs =

$$\frac{(SC.365)+(UR.AC)+(B1.AC)-(D1.AC)}{100} + (B2) - (D2)$$

Where:

DSCon means a Domestic Supply Contract or Deemed Contract;

SC means:

(a) In the case of a DSCon with 365 or more days remaining from the date of calculation, the sum of: each Relevant Standing Charge that applies to the DSCon (SC_i), expressed in pence per day, multiplied by the period of time in days for which it will apply (t_i) during the following 365 days, divided by 365;

$$\boldsymbol{SC} = \sum_i \frac{SC_i . t_i}{365}, \qquad \text{with} \sum_i t_i = 365$$

(b) In the case of a DSCon with fewer than 365 days remaining from the date of calculation, the combined total of (i) and (ii), divided by 365:

(i) the sum of: each Relevant Standing Charge that applies to the DSCon (SC_i^C), expressed in pence per day, multiplied by the period of time in days for which it will apply during the remaining duration of the contract (t_i^C);

(ii) the sum of: each Relevant Standing Charge that would apply under the Relevant Cheapest Evergreen Tariff for the Domestic Customer (SC_j^{RCE}), expressed in pence per day, multiplied by the period of time in days for which it will apply during the period between the end of the DSCon and the 365th day from the date of the calculation (t_j^{RCE});

$$\boldsymbol{SC} = \sum_i \frac{SC_i^C . t_i^C}{365} + \sum_j \frac{SC_j^{RCE} . t_j^{RCE}}{365}, \qquad \text{with} \sum_i t_i^C + \sum_j t_j^{RCE} = 365$$

UR means:

(a) In the case of a DSCon with 365 or more days remaining from the date of calculation, the sum of: each Relevant Unit Rate (*UR_i*) that applies to the DSCon over the next 365 days from the date of calculation, expressed in pence per kWh, multiplied by the percentage of the Domestic Customer's Annual Consumption Details that Relevant Unit Rate will apply to (or to which the licensee reasonably considers that Relevant Unit Rate will apply), having regard to Intra-Day Consumption Levels and Seasonal Consumption Levels, where applicable (C_i);

$$\boldsymbol{UR} = \sum_i UR_i \,.\, C_i, \qquad \text{with} \sum_i C_i = 100\%$$

(b) In the case of a DSCon with fewer than 365 days remaining from the date of calculation, the combined total of (i) and (ii):

(i) the sum of: each Relevant Unit Rate that applies to the DSCon (UR_i^C), expressed in pence per kWh, multiplied by the percentage of the Domestic Customer's Annual Consumption Details that Relevant Unit Rate will apply to (or to which the licensee reasonably considers that Relevant Unit Rate will apply) during the remaining duration of the DSCon, having regard to Intra-Day Consumption Levels and Seasonal Consumption Levels, where applicable (C_i^C);

(ii) the sum of: each Relevant Unit Rate that would apply under the Relevant Cheapest Evergreen Tariff for the Domestic Customer (UR_j^{RCE}), expressed in pence per kWh, multiplied by the percentage of the Domestic Customer's Annual Consumption Details that Relevant Unit Rate will apply to (or to which the licensee reasonably considers that Relevant Unit Rate will apply) during the period between the end of the DSCon and the 365th day from the date of calculation, having regard to Intra-Day Consumption Levels and Seasonal Consumption Levels, where applicable (C_j^{RCE});

$$\boldsymbol{UR} = \sum_i UR_i^C \,.\, C_i^C + \sum_j UR_j^{RCE} \,.\, C_j^{RCE},$$
$$\text{with} \sum_i C_i^C + \sum_j C_j^{RCE} = 100\%$$

AC means the Domestic Customer's Annual Consumption Details;

B1 means:

(a) In the case of a DSCon with 365 or more days remaining from the date of calculation, the sum of: each Consumption-Based Tied Bundle Charge (B_i) that applies to the DSCon over the next 365 days from the date of calculation, expressed in pence per kWh, multiplied by the percentage of the Domestic Customer's Annual Consumption Details the charge will apply to (or to which the licensee reasonably considers the charges will apply), having regard to Intra-Day consumption levels and Seasonal Consumption Levels, where applicable (C_i);

$$\boldsymbol{B1} = \sum_i B_i . C_i, \quad \text{with} \sum_i C_i = 100\%$$

(b) In the case of a DSCon with fewer than 365 days remaining from the date of calculation, the combined total of (i) and (ii):

(i) the sum of: each Consumption-Based Tied Bundle Charge (B_i^C), expressed in pence per kWh, multiplied by the percentage of the Domestic Customer's Annual Consumption Details the charge will apply to (or to which the licensee reasonably considers the charge will apply) during the remaining duration of the DSCon, having regard to Intra-Day Consumption Levels, and Seasonal Consumption Levels, where applicable (C_i^C);

(ii) the sum of: each Consumption-Based Tied Bundle Charge that applies to the Relevant Cheapest Evergreen Tariff for the Domestic Customer (B_j^{RCE}), expressed in pence per kWh, multiplied by the percentage of the Domestic Customer's Annual Consumption Details the charge will apply to (or to which the licensee reasonably considers the charge will apply to) during the period between the end of the DSCon and the 365th day from the date of the calculation, having regard to Intra-Day Consumption Levels and Seasonal Consumption Levels, where applicable (C_j^{RCE});

$$\boldsymbol{B1} = \sum_i B_i^C . C_i^C + \sum_j B_j^{RCE} . C_j^{RCE}, \quad \text{with} \sum_i C_i^C + \sum_j C_j^{RCE} = 100\%$$

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D1 means:

(a) In the case of a DSCon with 365 or more days remaining from the date of calculation, the sum of: each Consumption-Based Discount (D_i) that applies to the DSCon over the next 365 days from the date of calculation, expressed in pence per kWh, multiplied by the percentage of the Domestic Customer's Annual Consumption Details the discount will apply to (or which the licensee reasonably considers the discount will apply to), having regard to Intra-Day Consumption Levels and Seasonal Consumption Levels, where applicable (C_i);

$$\boldsymbol{D1} = \sum_i D_i . C_i, \qquad \text{with} \sum_i C_i = 100\%$$

(b) In the case of a DSCon with fewer than 365 days remaining from the date of calculation, the combined total of (i) and (ii):

(i) the sum of: each Consumption-Based Discount (D_i^C), expressed in pence per kWh, multiplied by the percentage of the Domestic Customer's Annual Consumption Details the discount will apply to (or to which the licensee reasonably considers the discount will apply) during the remaining duration of the DSCon, having regard to Intra-Day Consumption Levels, and Seasonal Consumption Levels, where applicable (C_i^C);

(ii) the sum of: each Consumption-Based Discount (D_j^{RCE}) that applies to the Relevant Cheapest Evergreen Tariff for the Domestic Customer, expressed in pence per kWh, multiplied by the percentage of the Domestic Customer's Annual Consumption Details the discount will apply to (or to which the licensee reasonably considers the discount will apply) during the period between the end of the DSCon and the 365th day from the date of the calculation, having regard to Intra-Day Consumption Levels and Seasonal Consumption Levels, where applicable (C_j^{RCE});

$$\boldsymbol{D1} = \sum_i D_i^C . C_i^C + \sum_j D_j^{RCE} . C_j^{RCE}, \quad \text{with} \sum_i C_i^C + \sum_j C_j^{RCE} = 100\%$$

B2 means:

(a) In the case of a DSCon with 365 or more days remaining from the date of calculation, the sum of: each Time-Based Bundle Charge (B_i), expressed in pounds sterling per day, multiplied by the period of time in days during the next 365 days for which the charge will apply (t_i);

$$\boldsymbol{B2} = \sum_i B_i . t_i, \qquad \text{with} \sum_i t_i = 365$$

(b) In the case of a DSCon with fewer than 365 days remaining from the date of calculation, the combined total of (i) and (ii):

(i) the sum of: each Time-Based Bundle Charge (B_i^C), expressed in pounds sterling per day, multiplied by the period of time in days for which it will apply during the remaining duration of the contract (t_i^C);

(ii) the sum of: each Time-Based Bundle Charge that applies to the Relevant Cheapest Evergreen Tariff for the Domestic Customer (B_j^{RCE}), expressed in pounds sterling per day, multiplied by the period of time in days for which it will apply during the period between the end of the DSCon and the 365th day from the date of calculation (t_j^{RCE});

$$\boldsymbol{B2} = \sum_i B_i^C . t_i^C + \sum_j B_j^{RCE} . t_j^{RCE}, \quad \text{with} \sum_i t_i^C + \sum_j t_j^{RCE} = 365$$

D2 means:

(a) In the case of a DSCon with 365 or more days remaining from the date of calculation, the sum of: each Time-Based Discount (D_i), expressed in pounds sterling per day, multiplied by the period of time in days during the next 365 days for which it will apply (t_i);

$$\boldsymbol{D2} = \sum_i D_i . t_i, \qquad \text{with} \sum_i t_i = 365$$

(b) In the case of a DSCon with fewer than 365 days remaining from the date of calculation, the combined total of (i) and (ii):

(i) the sum of: each Time-Based Discount (D_i^C), expressed in pounds sterling per day, multiplied by the period of time in days for which it will apply during the remaining duration of the contract (t_i^C);

(ii) the sum of: each Time-Based Discount that applies to the Relevant Cheapest Evergreen Tariff for the Domestic Customer (D_j^{RCE}), expressed in pounds sterling per day, multiplied by the period of time in days for which it will apply during the period between the end of the DSCon and the 365th day from the date of calculation (t_j^{RCE});

$$\begin{aligned} \boldsymbol{D2} = \sum_i D_i^C . t_i^C & \\ & + \sum_j D_j^{RCE} . t_j^{RCE}, \\ & \text{with} \sum_i t_i^C + \sum_j t_j^{RCE} = 365 \end{aligned}$$

Annex 2: Summary of responses to August 2016 policy consultation questions regarding changes to the Personal Projection

Question 1(a): *Do you agree with the proposed requirement that any calculation by a supplier of the estimated annual cost figure should be internally consistent (ie calculated in the same way by any given supplier for all tariffs and for all customers over time)?*

The majority of respondents agreed that the estimated annual cost (EAC) figure should be calculated in a way that was internally consistent (ie consistent across a supplier'' own tariff offerings). Some felt that internal consistency was not enough, arguing that unless there was consistency across the entire market consumers would be left confused. A number of stakeholders had specific suggestions. For example:

- Introduce a 'primary default view' for the Personal Projection (PP), calculated on an estimate of usage for the next 12 months and based on actual historic consumption if known, exclude additional one-off discounts, bonuses or loyalty offers to ensure like for like comparisons, and provide an option to separately view PP with discounts/bundles;
- Suppliers should be able to change the EAC methodology for new tariffs;
- The same methodology should be applied to all of a suppliers' tariffs at any given time;
- EAC calculations should be consistent across certain customer categories (eg time of use / non-time of use); and
- Price Comparison Websites (PCWs) should have access to suppliers' calculations in order to compare across the market.

One stakeholder suggested that it will not always be appropriate to calculate costs on an annual basis (eg for time of use tariffs, 'power pack' tariffs etc). One consumer group argued that the benefits of providing customers with regularly updated cost projections outweighed the potential risks of confusion caused by the removal of a consistently calculated EAC formula. Two suppliers questioned whether the PP was still required, given the proposed tariff comparability principles.

Question 1(b): *Are there any circumstances in which suppliers should have the flexibility to provide an estimated annual cost figure to customers based on different assumptions or methodologies? Please explain your answer.*

The vast majority of respondents stated that some flexibility should be provided, particularly when it comes to ToU tariffs, tariffs whose value is dependent upon behavioural change or tariffs with a duration of less than a year.

However, many respondents argued that, whilst flexibility would sometimes be necessary, there should be transparency around how any methodology is calculated and this should be clearly communicated to customers. One stakeholder went further, suggesting that Ofgem should require suppliers to justify their choice of methodology against the set criteria and that suppliers should provide evidence to show the criteria are being met.

Two respondents argued that no flexibility should be allowed as this could compound confusion.

Question 2: *Do you support our proposal to require that, in the absence of a prescribed methodology, the EAC must be personalised, transparent, fair and as accurate as possible, based on reasonable assumptions and all available data?*

Most respondents agreed with the introduction of some high-level requirements around the calculation of the EAC. However, there were a number of concerns with the proposal put forward. Some of these related to the way in which the proposal in the consultation was worded:

- Two stakeholders questioned the definition of 'fair', requesting clarification of whether it was the same definition of fairness as in the SOC; and
- Some suggested that 'all available data' and 'as accurate as possible' were disproportionate, arguing that suppliers should have more freedom to decide what is appropriate in specific situations.

Others were concerned that the introduction of a principles-based estimate would make it more difficult for PCWs to compare across suppliers, advocating a more prescriptive approach. One supplier suggested that consumers might be happy with an estimate based on an Ofgem-prescribed average rather than a personalised quote.