

# Financial protections for vulnerable consumers

## Technical Document

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Impact Assessment Form

<p>Title: Financial protections for vulnerable consumers</p> <p>Division: Consumers and Competition Team: Market Monitoring and Research</p> <p>Associated documents: Statutory consultation for a vulnerable customer safeguard tariff</p> <p>Coverage: Full coverage</p>	<b>Impact Assessment (IA)</b>
	Type of measure: Price Control / Retail Competition measures
	Type of IA: Qualified under Section 5A UA 2000.

**Summary:** Intervention and Options

Rationale for intervention, objectives and options

**What is the problem under consideration? Why is Ofgem intervention necessary?**

The “two-tier” retail energy market allows suppliers to charge high prices to consumers on default tariffs who do not engage. According to our latest data, around 64% of domestic customer accounts with the ten largest suppliers are on a standard variable tariff or “SVT” (typically a supplier’s default tariff). The price difference between the average SVTs from the six largest suppliers and the cheapest tariff in the market recently reached nearly £320.

Our research shows that many vulnerable consumers find it more difficult to engage in the market. Consumers with vulnerable characteristics – low income, social housing renters, aged 65 or over, living with a disability – are also more likely to lack confidence in engaging in the market, or to be wary of the potential risks. Consumers in vulnerable situations are also more likely to be on high-priced SVTs and spend a higher proportion of their income on energy. The impact of high energy prices is greater on poorer consumers, and continues to worsen, in 2015 the poorest 10 per cent of households spent an average of 9.7% of their income on energy, compared to 5.8% of their income in 2005.

As a result, our measures to improve competition are likely to take even longer to reach consumers at risk of being vulnerable, and these consumers are more likely to be adversely affected by higher energy prices in the short term. These consumers are suffering now, and need assistance as quickly as possible.

**What are the policy objectives and intended effects including the effect on Ofgem’s Strategic Outcomes**

We are seeking to reduce the impact of the current two-tier market on those most affected and most likely to be harmed by it. Our objective is to protect vulnerable consumers who have difficulty engaging in the market, to reduce the harm they experience on expensive, default tariffs.

We propose to put in place a short-term safeguard tariff from February next year, so that some vulnerable consumers can benefit from lower prices this winter. We therefore need to act quickly. To provide any relief during this winter it is important that we act now.

We aim to minimise any unintended consequences or market distortions. We also think that the protections we introduce should ensure that suppliers with efficient costs can compete, and that our proposals minimise the administrative burden and cost of implementation.

This proposal is designed to provide temporary protection until the government has implemented its plans for a broader price cap intervention. As a result, we are proposing the safeguard tariff will continue no later than December 2019.

**What are the policy options that have been considered, including any alternatives to regulation? Please justify the preferred option (further details in Evidence Base)**

In the Technical Document we discuss a range of options which we considered during the initial stages of policy development. We also compared all of the options against the ‘do nothing’ case – in which we take no new immediate action to protect vulnerable consumers, beyond the remedies that are already planned or being implemented.

We considered options such as a ban on SVTs and additional informational remedies, which were aimed at improving vulnerable consumer engagement and competition. We rejected these options because we consider that they are not guaranteed to result in financial protections to vulnerable consumers, or address the issues around engagement which vulnerable consumers have difficulty overcoming.

We considered a number of options which would deliver direct financial protection to vulnerable consumers, including our preferred option of applying a safeguard tariff to consumers who met a set of vulnerability criteria. Our overall assessment is that extending the prepayment meter (PPM) safeguard tariff to vulnerable consumers is the solution most likely to achieve our primary objective and, if designed appropriately, should achieve all of our supporting objectives.

**Preferred option - Monetised Impacts (£m)**

<b>Business Impact Target Qualifying Provision</b>	Not quantifiable at this stage
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<b>Business Impact Target (EANDCB)</b>	Not quantifiable at this stage
<b>Net Benefit to Ofgem Consumer</b>	Not quantifiable at this stage
<b>Wider Benefits/Costs for Society</b>	Not quantifiable at this stage
<p><b>Explain how was the Net Benefit monetised, NPV or other</b></p> <p>Where it was proportionate to do so, we quantitatively assessed the main impacts in monetised form, but in the main we concluded that it is more appropriate to present a qualitative assessment of our proposed option.</p> <p>We expect our proposals to directly reduce bills for around 0.91 million households. Around a further 1.28 million consumers on fixed tariffs, or currently protected by the prepayment cap, will not see immediate reductions in bills. But these consumers will be indirectly protected in the future if they roll onto a SVT or switch from a prepayment tariff to another payment method.</p> <p>Whilst these estimates are subject to some uncertainty, by comparing the PPM safeguard tariff to existing tariff levels available in the market, we estimate that the total reduction in eligible consumer bills will be around £100m per year. This results in an average saving of £110 per eligible customer per year (based on average household typical consumption). The methodology used to produce these estimates is explained in Annex B.</p> <p>It is also possible that suppliers increase the prices of SVTs to other customers to offset expected revenue decreases from the safeguard tariff, given that SVT customers are on average less engaged. In a competitive market, we would not expect suppliers to increase their prices to other consumers and would hope that any supplier that sought to do so would lose customers to its rivals. Nonetheless, within the impact assessment we have estimated the possible impacts on the bills of non-eligible consumers.</p>	

### Preferred option - Hard to Monetise Impacts

**Describe any hard to monetise impacts, including mid-term strategic and long-term sustainability factors following Ofgem IA guidance**

For a range of areas which we have not been able to monetise we have primarily conducted a qualitative assessment. Where possible, we have provided quantitative evidence to support our reasoning. We broadly conclude that unintended negative impacts can be mitigated through the existing regulatory framework and effective safeguard tariff design.

We assessed the indirect impacts on both eligible and non-eligible consumers, with a particular focus on the vulnerable such as the fuel poor. We evaluated impacts on engagement including consumer switching behaviour, finding that negative impacts on switching are possible, but likely to be marginal. We also assessed how price changes and changes in supplier behaviour could impact consumer welfare. We concluded that adequate provisions are in place to minimise negative impacts, such

as the amendments to the domestic supplier Standards of Conduct and Standard Licence Condition 22 of the supply licence.

We then assessed the impacts on supplier segments, looking at administration costs, supplier pricing and behavioural changes. We also assessed investor perspective, concluding that the proportionality of our proposals will limit the material impact on the cost of capital for energy suppliers. We have maintained a level of headroom within the cap design, which we believe will preserve the desirable characteristics of a competitive well-functioning market, protecting consumers.

Our assessments also consider longer-term considerations, such as impacts on the wider economy including niche markets and switching services, government and regulator administration costs, price volatility, changes in market structure and on levels of consumption.

### **Key Assumptions/sensitivities/risks**

The key assumption in our preferred option is that the 'prepayment methodology' for calculating the benchmark represents the costs of an efficient supplier. The methodology is designed to minimise the risk that this assumption is incorrect (see Annex A) but there may be some small differences in the costs of serving prepayment meter and vulnerable customers.

Inevitably there are risks involved in our preferred measure, should our assumptions prove to be inaccurate:

- If our assumption that the prepayment methodology reflects the costs of an efficient supplier is inaccurate, suppliers will make a loss on those customers who are eligible for protection.
- This could result in suppliers reducing the number of tariffs available to vulnerable consumers (i.e. only offering the safeguard tariff) and restricting choice.
- It could result in reduced customer service for vulnerable consumers, in order to reduce costs.
- It could result in a 'waterbed effect' where suppliers try to recover lost revenue from non-eligible customers.

In addition, we also considered the following risks in our assessment:

- Although vulnerable consumers are currently less engaged on average, our preferred option could further reduce engagement and make it more difficult for these consumers to benefit from competition in the future.
- There is no easy or perfect way to identify our target group of vulnerable consumers, and it is likely that our proposed eligibility criteria do not capture all of those who need protection.

The quantitative analysis of the impacts of our preferred measure on number of customers, consumer bills and supplier impact must use a number of simplifying assumptions to which the results are sensitive. These assumptions are explained further in Annex B. Examples of the assumptions used include the number of WHD on

prepayment meters, the proportion of vulnerable customers on SVTs by supplier, and the proportion of prepayment customers on SVTs.

<b>Will the policy be reviewed?</b> Yes	<b>If applicable, set review date:</b> December 2019 (latest)
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<b>Is this proposal in scope of the Public Sector Equality Duty?</b>	Yes
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**Summary Table for all options.**

Where possible, summarise the main impacts of each option to allow for easy comparison of benefits/costs (pros/cons). Make sure all options are summarised in comparable units.

<b>Summary of options</b>	<b>Main effects on Ofgem outcomes</b>	<b>Benefits</b>	<b>Costs</b>	<b>Key Considerations</b> (Risks, assumptions, distributional impacts etc.)
'Do nothing'	Minimise any unintended consequences but does not protect vulnerable consumers.	Minimise any market distortions and administrative burden.	No additional costs.	Vulnerable consumers would continue to experience detriment in the form of higher prices.
Options to improve engagement and competition (e.g. banning SVTs/ additional informational remedies etc)	Would not meet our main objective to protect vulnerable consumers who have difficulty engaging in the market and to reduce the harm they experience on expensive, default tariffs.	Depending on the specific option, may improve engagement for certain customers and help them get a better deal.	Expect lower costs than any direct financial protections.	Suppliers still control prices. Disengaged customers would still be likely to fall onto a default tariff, and be charged higher prices.

Safeguard tariff	Option which is most likely to achieve our objectives, by offering direct financial protection to eligible consumers whilst balancing our other objectives.	Estimated immediate reduction in bills for 0.9m households on default tariffs and future protection for a further 0.5m consumers currently on fixed tariffs.	Reduced revenues for suppliers. Some additional administrative and regulatory burden in implementing the new tariff. Costs likely to be small.	Benchmark methodology may not precisely reflect the costs of an efficient supplier. No easy or perfect solution to identifying vulnerable consumers. Suppliers may try to recover lost revenues from other SVT customers.
Obligation to offer a social tariff	No guaranteed reduction in detriment.	Flexibility for suppliers to set their own tariff levels and eligibility rules.	No additional costs.	Social tariffs were phased out because they did not offer adequate protection to vulnerable consumers. Inconsistent outcomes across suppliers.
Uniform rebate payments	Would not meet all of our objectives.	Would deliver direct benefits to eligible vulnerable consumers. Could be easy to design.	Reduced revenues for suppliers.	Would be less favourable to vulnerable consumers with high consumption. Not cost-reflective.

**Evidence Base (for summary sheets)**

Our evidence base for this statutory Impact Assessment is set out in the following documents:

*Statutory consultation for a vulnerable safeguard tariff*

*Financial protections for vulnerable consumers – technical document*

## Context

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The Competition and Markets Authority's (CMA) energy market investigation<sup>1</sup> concluded that suppliers have a position of unilateral market power in relation to customers who do not engage regularly in the market. It said that this was having an adverse effect on competition, and proposed a number of remedies to address the substantial consumer detriment it had identified. We have already implemented some of these remedies, and are currently developing and testing the rest.

One of the remedies was to introduce a safeguard tariff for consumers with prepayment meters, recognising that these consumers have a more limited choice of tariffs until the smart meter roll-out is complete.

In July we responded to the Secretary of State for Business, Energy and Industrial Strategy<sup>2</sup>, saying that we planned to do go beyond the CMA remedies, in order to help the more disadvantaged households.

We have a long-standing programme to help vulnerable consumers, building on our consumer vulnerability strategy.<sup>3</sup>

## Associated documents

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### **Statutory Consultation Letter**

<https://www.ofgem.gov.uk/publications-and-updates/statutory-consultation-vulnerable-customer-safeguard-tariff>

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<sup>1</sup> CMA (2016) Energy market investigation – final report  
<https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>

<sup>2</sup> [https://www.ofgem.gov.uk/system/files/docs/2017/07/20170703\\_-\\_letter\\_from\\_dermot\\_nolan\\_to\\_the\\_secretary\\_of\\_state.pdf](https://www.ofgem.gov.uk/system/files/docs/2017/07/20170703_-_letter_from_dermot_nolan_to_the_secretary_of_state.pdf)

<sup>3</sup> Ofgem (2013) Consumer Vulnerability Strategy  
<https://www.ofgem.gov.uk/ofgem-publications/75550/consumer-vulnerability-strategy-pdf>



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# 1. Introduction

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## Chapter Summary

In this chapter we describe the purpose of this document and how it relates to the other documents published alongside it. We describe the approach we have taken to the impact assessment and provide an overview of the document structure.

## Purpose of this document

- 1.1. In the accompanying Statutory Consultation Letter or "*Consultation Letter*", we have published our proposals to introduce financial protections for vulnerable consumers. We propose to temporarily extend the existing safeguard tariff for consumers with prepayment meters to an easily identifiable group of vulnerable consumers in February 2018.
- 1.2. If you have any views on our statutory impact assessment, the response deadline is **9am on Monday 13 November**. We seek your views particularly if you have any additional considerations in relation to a vulnerable safeguard tariff.
- 1.3. Our intention is to help vulnerable consumers who have difficulty engaging in the market and face barriers to obtaining the best deals. This can include, for example, those who are less able to engage with the retail energy market because of a disability, and those who are on lower incomes and may face hardship from paying high prices. Chapter 4 sets out how we intend to define vulnerability and why we have decided to intervene to protect certain vulnerable consumers as quickly as possible, giving early relief to consumers who are more likely than most to suffer detriment.
- 1.4. The purpose of this technical document is to support the consultation letter by explaining the rationale for rapid implementation of a vulnerable customer safeguard tariff and set out the potential impacts of our proposals. This technical document incorporates our statutory impact assessment, which has quantitative and qualitative elements.
- 1.5. In carrying out our assessment and undertaking the necessary analysis we have been guided by the principle of proportionality. The level of analysis presented here reflects an appropriate balance between analytical rigour, the relative costs and benefits involved in performing further analysis and the need to act quickly. Where it was proportionate to do so, we have quantitatively assessed the main impacts in monetised form. Generally we concluded that it was more appropriate to present a qualitative assessment of the proposed measures and how they are likely to impact on the groups in focus.
- 1.6. Our analysis is based on the assessment of our proposal against the counterfactual scenario (or base case). Ideally, the counterfactual would

represent our best judgment as to what would have occurred in the absence of the proposed temporary safeguard tariff measure. It is possible that in the absence of our proposals new protections would emerge for vulnerable customers. However, at this stage, we are unaware of the existence of any contingent proposals which would come into effect at the same time as our proposals. Therefore our baseline reflects the state of the market based on the latest data available to us and the impacts of policies which have already been announced.

- 1.7. We have assessed the net impact on consumers, suppliers and the wider market.
- 1.8. In order to comply with our proposals, we expect that suppliers will create a new tariff for vulnerable consumers. Whilst it is difficult to forecast how tariffs might have evolved in the absence of our intervention, we have carried out an ex-ante assessment of the potential savings for vulnerable consumers and the impact on suppliers' revenues. We must stress that the quantitative analysis should not be taken as a precise measure of the effects of our proposals as, by necessity, we consider only the static effects and make extensive use of stylised assumptions to which the final results may be sensitive.
- 1.9. In parallel with this consultation, we will work with the government on its plans for a price cap for all customers on Standard Variable Tariffs (SVTs) and other default tariffs.

## **The structure of this document**

- 1.10. In this document, we explain the rationale for our proposed approach, including an assessment of the different options we considered to offer swift protection for vulnerable consumers.
- 1.11. In Chapter 2 we discuss the reasons why we consider that disengaged vulnerable consumers need protection, and our objectives for such protection.
- 1.12. In Chapter 3 we analyse different options for protection by assessing the likelihood that they would achieve our objectives. We conclude that a temporary safeguard tariff is the best option.
- 1.13. One of our key objectives is to ensure that we can extend protection to vulnerable consumers as soon as possible. In Chapter 4, we explain the rationale for providing direct protection in the short-term to vulnerable consumers, who find it difficult to engage with the market. We also outline the proposed scope of eligibility for our proposals.
- 1.14. In Chapter 5 we then set out our qualitative and quantitative assessment of the proposed vulnerable customer safeguard tariff, based on the potential impacts on consumers, suppliers and the wider market.

- 1.15. In Chapter 6 we provide an initial discussion of how we will monitor and evaluate the vulnerable customer safeguard tariff.

## 2. Why we need to act

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### Chapter Summary

The reasons why we consider that disengaged vulnerable consumers need protection, and our objectives for such protection.

### The two-tier market

- 2.1 The domestic retail energy market<sup>4</sup> is split into two tiers, where energy prices are very different depending on whether or not a consumer engages (by changing tariff or supplier). Engaged consumers benefit from competition and get good deals, while those who do not engage face high prices. This two-tier market is a big concern for us, particularly given its impact on certain vulnerable consumers.
- 2.2 There are signs that competitive pressures are improving. For example, last year<sup>5</sup> the number of domestic consumers switching supplier increased by 20% in electricity and 17% in gas.<sup>6</sup> However, suppliers are still able to charge disengaged consumers prices that are well above the cheapest deals available in the market. According to our latest data, around 64% of domestic customer accounts with the larger ten suppliers are on an SVT.<sup>7</sup> The price difference between the average SVT from the six largest suppliers and the cheapest tariff in the market recently reached around £300.<sup>8</sup>
- 2.3 The two-tier market was recognised by the Competition and Markets Authority's (CMA) energy market investigation, which concluded in 2016. One of its major findings was that suppliers have a position of unilateral market power in relation to customers who do not engage regularly in the market. The CMA concluded that this was having an adverse effect on competition and leading to substantial consumer harm.
- 2.4 The CMA introduced multiple remedies to address this problem. These included placing requirements on suppliers to trial different ways of engaging consumers, establishing a database that helps disengaged customers to find better deals and

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<sup>4</sup> Any references to "market" in this document should not be interpreted as indicating the approach that we would take to define the market for the purposes of the Competition Act.

<sup>5</sup> Year ending June 2017.

<sup>6</sup> Ofgem analysis of data from electricity distribution network operators and Xoserve.

<https://www.ofgem.gov.uk/data-portal/retail-market-indicators>

<sup>7</sup> Figure for April 2017, based on Ofgem analysis of supplier data submissions.

<https://www.ofgem.gov.uk/data-portal/retail-market-indicators>

<sup>8</sup> For a dual fuel customer paying by direct debt, at the medium Typical Domestic Consumption Values. Data from July 2017.

<https://www.ofgem.gov.uk/data-portal/retail-market-indicators>

introducing a safeguard tariff<sup>9</sup> for prepayment meter customers who face higher barriers to switching. These remedies are working alongside other Ofgem initiatives to improve consumer engagement. These include: improving suppliers' communications with consumers, monitoring the rollout of smart meters, and making it quicker and easier for consumers to switch supplier. However, we explain below why we think further action is needed to protect vulnerable consumers.

## Impacts of the two-tier market on vulnerable consumers

2.5 The section summarises how the two-tier market affects vulnerable consumers.

### Vulnerable consumers are less likely to engage...

- 2.6 Consumers in circumstances or with characteristics that indicate they are at a higher risk of being vulnerable are often more likely to be disengaged and on a more expensive SVT. The CMA's research indicated that the group with the highest proportion of customers on SVTs were those living in rented social housing (83%). Other demographics with a higher than average proportion of SVT customers included those who have household incomes below £18,000 (75%), customers with no qualifications (73%) and customers who are disabled (74%).<sup>10</sup>
- 2.7 The CMA also found that consumers with the following characteristics were less likely to have switched supplier in the last three years: household income under £18,000 a year; living in rented social housing; no qualifications; aged 65 or over; and living with a disability or registered on the Priority Services Register.<sup>11</sup>
- 2.8 These patterns are broadly mirrored in the 2017 Ofgem Consumer Engagement Survey which also highlights that consumers with those characteristics – low income, social housing renters, aged 65 or over, living with a disability - use the

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<sup>9</sup> This is formally known as the Prepayment Charge Restriction, and is set out in Standard Licence Condition 28A of the electricity and gas supply licences.

<sup>10</sup> CMA (2016), Energy market investigation – final report, paragraph 9.14.  
<https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>

<sup>11</sup> CMA (2016) Energy market investigation final report. Appendix 9.1: CMA domestic customer survey results, paragraph 83.  
<https://assets.publishing.service.gov.uk/media/576bcbbc40f0b652dd0000b0/appendix-9-1-cma-domestic-customer-survey-results-fr.pdf>

internet less often than other consumers.<sup>12</sup> Low frequency of internet use is itself associated with lower levels of supplier switching.<sup>13</sup>

- 2.9 Tracking data from 2014 to 2017 also reveals differences between the changes in engagement between different groups of vulnerable consumers. Overall there have been steady increases in the proportion of consumers switching supplier (from 14% to 18%) and engaging in the market more broadly<sup>14</sup> (from 35% to 41%). However, in addition to starting from lower levels of switching and engagement, the rate of switching for consumers with low frequency of internet use has remained essentially static over the period, and levels of engagement in the energy market by customers with a disability are also showing a lower rate of increase (from 12% to 14%).<sup>15</sup> In contrast, consumers on incomes of less than £16,000 have shown a rate of switching growth in line with all consumers (11% to 15%), and a greater rate of growth in engagement (from 26% to 35%).
- 2.10 Consumers with vulnerable characteristics – low income, social housing renters, aged 65 or over, living with a disability – are also more likely to lack confidence in engaging in the market, or to be wary of the potential risks. This is shown in our consumer engagement segments.<sup>16</sup> Those on incomes of less than £16,000 a year and those in rented social housing are more likely to be “Anxious Avoiders”, characterised by their relatively low levels of self-efficacy and lack confidence in shopping around generally and in energy, reflected in low levels of engagement across all markets. Those aged 65 or older and those with a disability are more likely than average to be “Contented Conformers”, who specifically lack confidence in engaging with the energy market, are largely satisfied with their current supplier and lack an incentive to face the perceived challenge and hassle of comparing tariffs or changing deal.
- 2.11 Some vulnerable consumers do engage, and we want this engagement to grow. In line with our Consumer Vulnerability Strategy, we want to ensure that

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<sup>12</sup> GfK (2017) Consumer Engagement in the Energy Market 2017: Report on a survey of energy consumers – Data Tables  
[https://www.ofgem.gov.uk/system/files/docs/2017/09/consumer\\_engagement\\_survey\\_2017\\_data\\_tables.xlsx](https://www.ofgem.gov.uk/system/files/docs/2017/09/consumer_engagement_survey_2017_data_tables.xlsx)

<sup>13</sup> GfK (2017) Consumer Engagement in the Energy Market 2017: Report on a survey of energy consumers  
[https://www.ofgem.gov.uk/system/files/docs/2017/09/consumer\\_engagement\\_survey\\_2017\\_report.pdf](https://www.ofgem.gov.uk/system/files/docs/2017/09/consumer_engagement_survey_2017_report.pdf)

<sup>14</sup> Engagement is defined as switching supplier, changing tariff with the same supplier, or actively comparing the market in the previous 12 months.

<sup>15</sup> GfK (2017) Consumer Engagement in the Energy Market 2017: Report on a survey of energy consumers; TNS (2016) Consumer engagement in the energy market since the Retail Market Review. Full data available from: <https://www.ofgem.gov.uk/consumers/consumer-research/research-surveys-household-consumers>

<sup>16</sup> GfK (2017) Consumer Engagement in the Energy Market 2017: Report on a survey of energy consumers  
[https://www.ofgem.gov.uk/system/files/docs/2017/09/consumer\\_engagement\\_survey\\_2017\\_report.pdf](https://www.ofgem.gov.uk/system/files/docs/2017/09/consumer_engagement_survey_2017_report.pdf)

vulnerable consumers have equal access to the market. We seek to empower consumers in vulnerable situations, as well as protecting them.<sup>17</sup>

- 2.12 However, we are wary that actions to boost engagement may not be as effective for all vulnerable consumers. Where vulnerable circumstances or characteristics are more intractable (for example, someone who cannot easily access or use the internet, or someone who has learning difficulties), it may be very difficult or not appropriate to increase their engagement. Any progress may be slow. For some vulnerable consumers, this situation could get worse in the future as more complicated time of use tariffs and other new products are offered.

### **...and suffer more**

- 2.13 Consumers in vulnerable situations are more likely to suffer in a number of ways, including struggling to afford bills.<sup>18</sup>
- 2.14 The impact of high energy prices is greater on poorer consumers, and the situation has got worse. In 2015, the poorest 10 per cent of households spent an average of 9.7% of their income on energy, compared to 5.8% of their income in 2005. Over the same period, the proportion of income that the richest 10% of households spend on energy was much lower, and changed less (2.1% in 2005 and 2.8% in 2015).<sup>19</sup> One consequence of the poorest consumers paying high prices is that they can under-heat their properties in winter, which can harm their health and social well-being.<sup>20</sup> Low income is therefore a particularly important risk factor when considering the impact of high-priced tariffs on consumers.
- 2.15 In 2015, the proportion of households in fuel poverty in England was estimated at 11%.<sup>21</sup> Fuel poverty is defined in different ways in England, Scotland and Wales<sup>22</sup> - but in each case, higher energy prices increase the number of people falling into fuel poverty. However, consumers who are not defined as fuel poor

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<sup>17</sup> Ofgem (2013), Consumer Vulnerability Strategy, paragraph 2.5.

<https://www.ofgem.gov.uk/publications-and-updates/consumer-vulnerability-strategy>

<sup>18</sup> Ofgem (2013), Consumer Vulnerability Strategy, paragraph 3.5.

<https://www.ofgem.gov.uk/publications-and-updates/consumer-vulnerability-strategy>

<sup>19</sup> Ofgem calculations based on Office for National Statistics data.

<https://www.ofgem.gov.uk/data-portal/energy-spend-percentage-total-household-expenditure-uk>

<sup>20</sup> Centre for Sustainable Energy (2015), Energy tariff options for consumers in vulnerable situations, p95.

<https://www.cse.org.uk/downloads/reports-and-publications/fuel-poverty/policy/energy-justice/tariff-options-for-vulnerable-consumers.pdf>

<sup>21</sup> BEIS (2017) Annual Fuel Poverty Statistics Report 2017 (2015 data)

<https://www.gov.uk/government/statistics/annual-fuel-poverty-statistics-report-2017>

<sup>22</sup> In England, a consumer is defined as fuel poor if they have above average energy needs and paying for this amount of energy would leave them below the official poverty line. In Scotland and Wales, a consumer is defined as fuel poor if they would have to spend 10% of their income to achieve adequate standards of warmth (but the calculations differ).



may still incur more harm from high prices if they are on a lower income, compared to consumers in general.

- 2.16 We recognise that prices are only one input to energy bills. The amount vulnerable consumers spend on energy is also affected by the amount they consume. Policies like the Energy Company Obligation (ECO) have sought to improve energy efficiency among certain consumers, in order to reduce their bills.

## The need to act

2.17 We want to:

- **Protect vulnerable consumers who have difficulty engaging in the market<sup>23</sup>, to reduce the harm they experience on expensive, default tariffs...**

We are seeking to reduce the impact of the current two-tier market on those most affected and most likely to be harmed by it. The government has the primary role in addressing fuel poverty, particularly for policy aimed at redistributing substantial costs between energy consumers.<sup>24</sup> Our objective is to reduce consumer harm, rather than to redistribute costs.

Our objective is therefore to reduce the impact of expensive default tariffs<sup>25</sup> on consumers who are both vulnerable and less able to engage. Given that there is no perfect way of identifying these consumers, in practice any target group will also include consumers who are likely to meet one or the other of these descriptions.

- **... until the government price cap and wider market reforms take effect**

At this stage, we are not seeking to determine whether a longer-term measure is required, or what form that could take.

- 2.18 In light of the evidence above about the two-tier market and its impact on vulnerable consumers, we are therefore proposing to introduce protection for a

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<sup>23</sup> Or in certain cases are unable to engage in the market.

<sup>24</sup> Ofgem (2016), Ofgem's regulatory stances, p8.

[https://www.ofgem.gov.uk/system/files/docs/2016/12/ofg930\\_ofgems\\_regulatory\\_stances\\_document\\_web.pdf](https://www.ofgem.gov.uk/system/files/docs/2016/12/ofg930_ofgems_regulatory_stances_document_web.pdf)

<sup>25</sup> Default tariffs are those which a consumer has not chosen actively. At present, these default tariffs are SVTs.

group of consumers at greater risk of vulnerability who are on default tariffs. We are proposing immediate action.

2.19 In general, we think that any such protection should:

- be capable of rapid implementation;
- minimise unintended consequences and market distortions;
- complement our wider market reforms by maintaining an incentive for consumers who are able to, to engage;
- ensure that suppliers with efficient costs can compete; and
- minimise the administrative burden and cost of implementation.

2.20 It is our view that such action would be consistent with our statutory objective of protecting the interests of existing and future energy consumers, and our general duties to have regard to the interests of certain groups who are vulnerable and to consider protecting the interests of consumers via means other than the promotion of competition.<sup>26</sup>

2.21 Our proposals will only address certain aspects of some vulnerable consumers' needs. We expect suppliers do much more to identify customers in need, and consider how they will help them – in line with their obligations relating to vulnerable consumers, including the new vulnerability principle in the domestic Standards of Conduct.<sup>27</sup>

2.22 We also believe suppliers can do more right now – and encourage them to think what they can do to help vulnerable consumers manage their energy costs in advance of the vulnerable customer safeguard tariff coming in.

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<sup>26</sup> We may also have regard to the interests of other groups of consumers.

<sup>27</sup> The new vulnerability principle will take effect in the supply licences from 10 October 2017. Ofgem (2017), Final decision: Standards of Conduct for suppliers in the retail energy market. <https://www.ofgem.gov.uk/publications-and-updates/final-decision-standards-conduct-suppliers-retail-energy-market>

## 3. Assessment of options to protect vulnerable consumers

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### Chapter Summary

This chapter sets out our assessment of the options which we considered in developing our approach to providing swift protection of vulnerable consumers.

- 3.1 In this chapter we discuss the range of options which we have considered against a 'do nothing' option, which would involve taking no immediate action to provide protections to vulnerable customers. This would mean no further protections or support provided beyond the engagement remedies proposed by the Competition and Markets Authority (CMA) as part of its energy market investigation<sup>28</sup> and the government's plans for a wider price cap.
- 3.2 The options broadly fall into two categories; measures which aim to prompt engagement and improve competition for vulnerable consumers and measures designed to provide direct financial protection for vulnerable consumers.
- 3.3 We assessed each option against our objectives, as presented in Chapter 2.

### Options to improve engagement and competition

#### *Do nothing (our counterfactual)*

- 3.4 One option available to us is to take no new immediate action to protect vulnerable consumers beyond the wider price cap announced by the government, and the remedies which the CMA proposed as part of its energy market investigation<sup>29</sup>, which we have either already implemented or are currently developing and testing as part of our ongoing work to promote competition and engagement. This option represents our counterfactual scenario against which we measure all other options.
- 3.5 We considered the 'do nothing' option against all of our stated policy objectives.<sup>30</sup> Since it does not go any further than actions which are already planned, it satisfies our objectives to minimise any unintended consequences, market

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<sup>28</sup> CMA (2016) Energy market investigation – Final report  
<https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>

<sup>29</sup> CMA (2016) Energy market investigation – Final report  
<https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>

<sup>30</sup> Our objectives are explained in the statutory consultation letter.

distortions and administrative burdens, and would enable suppliers with efficient costs to compete.

- 3.6 However, we considered that it would fail our objective to reduce the impact of expensive default tariffs on vulnerable consumers who have difficulty engaging in the market. We particularly considered that this option is not compatible with one of our key objectives, which is to ensure that we can extend protection to vulnerable consumers as soon as possible.
- 3.7 Consumers in circumstances or with characteristics that indicate they are at a higher risk of being vulnerable are often more likely to be disengaged and on a more expensive SVT. The CMA's research indicated that the group with the highest proportion of customers on SVTs were those living in rented social housing (83%). Other demographics with a higher than average proportion of SVT customers included those who have household incomes below £18,000 (75%), customers with no qualifications (73%) and customers who are disabled (74%).<sup>31</sup>
- 3.8 The CMA also found that consumers with the following characteristics were less likely to have switched supplier in the last three years: household income under £18,000 a year; living in rented social housing; no qualifications; aged 65 or over; and living with a disability or registered on the Priority Services Register.<sup>32</sup>
- 3.9 Our research on consumer engagement in the energy market also shows that vulnerable consumers are significantly less likely to engage with the market or switch tariffs.<sup>33</sup> Considering the evidence on the length of time that disengaged consumers spend on SVTs,<sup>34</sup> we are concerned that existing remedies may not work quickly enough for those who are most likely to suffer detriment. Given the degree of price dispersion between SVTs and fixed tariffs,<sup>35</sup> there is a significant cost incurred by vulnerable consumers during any period before these existing remedies may help these consumers. Furthermore, where vulnerable consumers

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<sup>31</sup> CMA (2016), Energy market investigation – final report, paragraph 9.14.

<https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>

<sup>32</sup> CMA (2016) Energy market investigation final report. Appendix 9.1: CMA domestic customer survey results, paragraph 83.

<https://assets.publishing.service.gov.uk/media/576bcbbc40f0b652dd0000b0/appendix-9-1-cma-domestic-customer-survey-results-fr.pdf>

<sup>33</sup> For example: GfK (2017) Consumer engagement in the energy market 2017. Report on a survey of energy consumers. Research conducted on behalf of Ofgem. Page 15.

[https://www.ofgem.gov.uk/system/files/docs/2017/09/consumer\\_engagement\\_survey\\_2017\\_report.pdf](https://www.ofgem.gov.uk/system/files/docs/2017/09/consumer_engagement_survey_2017_report.pdf)

<sup>34</sup> In April 2017, 34% of domestic customer accounts paying by non-prepayment methods were SVT accounts held for more than three years, whereas 25% were SVT accounts held for less than three years.

<https://www.ofgem.gov.uk/data-portal/retail-market-indicators>

<sup>35</sup> See the statutory consultation letter.

must overcome particularly intractable circumstances, there is a strong possibility that these remedies will never work for certain vulnerable consumers.

- 3.10 Overall, our conclusion is that the 'do nothing' option would not meet our objectives.

*Introduce a ban on SVTs*

- 3.11 We recently published our decision to allow suppliers to roll customers onto a further fixed-term tariff where that would represent a better outcome for the customer than defaulting onto an SVT.<sup>36</sup> This will enable suppliers to reduce the stock of customers on SVTs voluntarily, by switching disengaged consumers onto another fixed-term tariff at the end of their existing deal. We are expecting suppliers to run some trials which will help us to understand whether ending the SVT has a significantly better impact on consumers than measures which focus on prompting customers on default tariffs to engage.
- 3.12 An extension of this proposal would be to abolish the SVT altogether. We cannot abolish default tariffs altogether, but we could restrict suppliers from offering variable tariffs. There are practical and legal considerations when implementing a radical market-wide change of this nature, affecting the speed at which any benefits could be realised, which would take considerable time to work through.
- 3.13 Disengaged customers would still be likely to fall onto a default tariff, but one potential advantage of this option is that consumers could be encouraged to engage by their supplier. For example, this might be through prompts at the end of a fixed contract. However, it could be assumed that a prompt is less likely to be effective for vulnerable consumers, particularly if these consumers face barriers which prevent them from engaging in the market, such as a lack of internet access.<sup>37</sup>
- 3.14 Because default tariff prices would still be controlled by suppliers, the main disadvantage of this option is that if vulnerable consumers do not make an active choice, they will continue to be charged higher prices.
- 3.15 It is also possible that banning variable tariffs could have wider unintended consequences on the rest of the market. For example, it could reduce consumer welfare through the loss of choice, as some consumers may actively choose to be on a variable tariff where it represents good value, or if they do not want to

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<sup>36</sup> Ofgem (2017) Final Decision – default tariffs for domestic customers at the end of fixed-term contracts <https://www.ofgem.gov.uk/publications-and-updates/decision-default-tariffs-domestic-customers-end-fixed-term-contracts>

<sup>37</sup> GfK (2017) Consumer Engagement in the Energy Market 2017: Report on a survey of energy consumers. Page 66  
[https://www.ofgem.gov.uk/system/files/docs/2017/09/consumer\\_engagement\\_survey\\_2017\\_report.pdf](https://www.ofgem.gov.uk/system/files/docs/2017/09/consumer_engagement_survey_2017_report.pdf)

actively engage on a regular basis. This is an important consideration given the CMA's finding that some of our previous tariff restrictions had an adverse effect on competition. Moreover, it is possible that by banning variable tariffs, suppliers would have reduced incentives to innovate and provide new service offerings.

- 3.16 We think that the best approach would minimise the number of customers on default deals by removing the barriers to engagement and improving the information that customers need to switch tariff or supplier. We are minded not to ban SVTs at the present time because we will give careful consideration to our approach to SVTs after the conclusion of the trials which we expect to conduct with suppliers. But we are worried that some customers might face specific barriers to engaging which are difficult to address.

*Additional informational remedies*

- 3.17 Under this option, vulnerable consumers could be targeted with additional prompts – for example personalised and targeted savings messages. Alternatively, they could be encouraged to join a collective switch.
- 3.18 The advantage of this option is that it would align with our broader work on developing prompts to engage. Market-based solutions may also reduce the risk of an intervention creating distortions.
- 3.19 However, this option may not deliver benefits as quickly as a vulnerable customer safeguard tariff. If consumers do not engage with the information or participate in the collective switch, then they will not receive financial protection. While additional information remedies or collective switches may form part of the longer-term solution for vulnerable consumers, they may not meet our objectives for this immediate measure.

*Other alternatives considered*

- 3.20 We also considered a range of other alternative options, but felt that none of them were likely to meet our main objective of protecting vulnerable consumers who have difficulty engaging in the market effectively as soon as possible, to reduce the harm they experience on expensive default tariffs. We briefly summarise these options in the following paragraphs.
- 3.21 **Mandated Tariff Design.** One alternative might be to mandate suppliers to use a particular tariff design which could help low energy users. Whilst this option could be implemented relatively quickly, overall we concluded that it would be less effective than a safeguard tariff because it would not restrict the prices which suppliers could set.
- 3.22 Furthermore, we considered how this option would work in practice and concluded that a "one size fits all" approach to tariff design was unlikely to meet any of our other objectives. For example, we could mandate a tariff without a standing charge which would target protection at users with low consumption.

But any benefits for low energy consumers would be offset by the negative impact on vulnerable consumers with high energy usage needs. Restricting tariff formats could also constrain innovation which might benefit vulnerable consumers. For example, the CMA found that previous restrictions on the format of tariffs introduced in the 'simpler choices' component of our Retail Market Review (RMR) rules (particularly the four-tariff rule) had an adverse effect on competition for prepayment customers.<sup>38</sup>

- 3.23 **Mandatory SVT format.** We also considered a measure based on regulating tariff formats.<sup>39</sup> Under this approach, external costs (including wholesale and network costs) would be passed through to customers and suppliers would compete over a published, but unregulated, margin. With this information, consumers could compare suppliers and, if successful, the suppliers would face more competitive pressure to reduce their margins by cutting costs within their control.
- 3.24 Whilst this option would be relatively quick to implement and have a low probability of introducing market distortions, it is not guaranteed to result in financial protection to vulnerable consumers. Importantly, it would depend upon a competitive response by suppliers and whilst publishing margin information might help engaged consumers, vulnerable consumers may not engage.
- 3.25 **Abolish price differentials between payment methods.** We considered preventing suppliers from charging different prices dependent on a consumer's payment method. This could benefit consumers paying by standard credit who are not able to take up cheaper payment methods such as direct debit.
- 3.26 But this intervention would not directly control the overall level of prices in the market or offer protection to vulnerable consumers (especially those who already pay by direct debit). We also considered the risk that this option would have unintended consequences on competition, as per the CMA's findings on the impact of a previous non-discrimination licence condition (SLC 25A), which was likely to have softened competition on SVTs.<sup>40</sup>

## Options to deliver direct financial protection to vulnerable consumers

### *Safeguard tariff*

- 3.27 This option would require suppliers to apply a regulated safeguard tariff to consumers who met a set of vulnerability criteria. The safeguard tariff would

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<sup>38</sup> CMA (2016) Energy market investigation final report, paragraph 9.476(a) <https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>

<sup>39</sup> For example, see Helm (2015), *Penalty tariffs, open-ended regulation and embedding overcharging – a critique of the CMA provisional findings and remedies*, paragraph 51 onwards.

<sup>40</sup> CMA (2016) Energy market investigation final report, paragraph 18.9(b)

restrict the prices that suppliers can charge to eligible consumers. Provided that the safeguard tariff is calculated and set such that it was lower than the most expensive, default tariffs, this option would offer direct protection to disengaged consumers. It could also be set such that it covered suppliers' efficient costs. Depending on the methodology adopted to set the tariff, we consider that this option is likely to meet our primary objective, and should also meet our objective to enable suppliers with efficient costs to compete.

- 3.28 We then assessed the safeguard tariff against our objective to act quickly. In our view, the speed at which the safeguard tariff can be implemented also depends on the methodology used to set the tariff. As we discuss later in this chapter, there are a number of possible options. The prepayment safeguard tariff methodology<sup>41</sup> is already established and understood by the industry, but there are other options which have not been used before and rely on different sources of data. In order to meet this objective to apply immediate protections to customers this winter, we would need to rely on the prepayment methodology.
- 3.29 A safeguard tariff can be designed to complement the wider reforms which are underway in the market, such as the roll-out of smart meters and the engagement remedies proposed by the CMA. Headroom can be used to allow suppliers (with efficient costs) to compete for vulnerable consumers on price, therefore maintaining some incentive for consumers to engage. Where some vulnerable consumers are unable to take advantage of the wider reforms, a safeguard tariff can provide them with protection.
- 3.30 Another objective is that the measure minimises any unintended consequences or market distortions. One of the main challenges for the safeguard tariff is whether it would result in price increases for other (non-eligible) consumers, in order to recover the lost revenue from vulnerable consumers. For the most engaged consumers, this risk is mitigated by competition and the opportunity to switch onto cheaper tariffs available in the market. But there may also be a group of other consumers who are not eligible for the protection of the safeguard tariff but only occasionally engage with the market, and may find themselves on more expensive tariffs. There may also be wider effects on competition and the incentives for new entrants to enter the retail market. We believe that these risks can be mitigated through safeguard tariff design. We have considered later within this chapter the role that headroom will play to minimise any unintended consequences or market distortions.
- 3.31 Finally, we aim to minimise the administrative burden for the government and suppliers. Whilst there is likely to be some additional burden involved in implementing a new safeguard tariff, we think there are options to mitigate these costs.

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<sup>41</sup> Ofgem (2017) *Background on prepayment meter safeguard tariff*  
<https://www.ofgem.gov.uk/publications-and-updates/background-prepayment-meter-safeguard-tariff>



- 3.32 Our overall assessment is that a new vulnerable customer safeguard tariff is the solution most likely to achieve our primary objective and, if designed appropriately, should achieve all of our supporting objectives.

*Obligation to offer a social tariff*

- 3.33 We considered an option in which suppliers would be required to offer a social tariff. Social tariffs previously existed to help households in fuel poverty, but they were voluntary schemes which varied by supplier. Voluntary supplier actions, such as social tariffs, were replaced by the Warm Home Discount. The rationale in the associated impact assessment said that a regulated scheme would “significantly improve the targeting and cost-effectiveness of expenditure and the clarity for eligible households”.<sup>42</sup>
- 3.34 Under this option, suppliers would retain the ability to set their own tariff levels and eligibility criteria (building on the criteria used for the WHD scheme), potentially in conjunction with consumer groups. This would give suppliers flexibility to offer support to vulnerable consumers in innovative ways and would align with our broader aim to make suppliers take responsibility for thinking about how they treat their consumers, especially vulnerable consumers.
- 3.35 However, this option would not guarantee a reduction in the detriment faced by vulnerable consumers, if suppliers retained control over their tariff levels. The level of protection could also vary across suppliers, leading to inconsistent outcomes. We considered that if we tried to address this by providing suppliers with detailed guidance on how to set their social tariff, the benefits of flexibility would be reduced and the outcomes could be similar to a safeguard tariff.

*Uniform rebate payments*

- 3.36 Finally, we considered whether it would be more effective to require suppliers to provide rebates to a defined group of vulnerable consumers.
- 3.37 Some suppliers have already done this on a voluntary basis for vulnerable consumers in the WHD Core Group.<sup>43</sup> Like a safeguard tariff, a rebate would deliver direct benefits to eligible vulnerable consumers. However, it could potentially have fewer parameters, and so might be easier to design than a safeguard tariff.
- 3.38 On balance, however, we were concerned that a uniform rebate payment across vulnerable consumers was likely to deliver a lower level of protection to

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<sup>42</sup> DECC (2011) Impact Assessment: The Warm Home Discount Scheme (DECC0027) [http://www.legislation.gov.uk/ukia/2011/619/pdfs/ukia\\_20110619\\_en.pdf](http://www.legislation.gov.uk/ukia/2011/619/pdfs/ukia_20110619_en.pdf)

<sup>43</sup> The Core Group assists recipients of the Pension Credit Guarantee Credit. See Regulation 6(2) of the Warm Home Discount Regulations 2011.

vulnerable consumers with high energy use. We felt it would be unfair to penalise a particular group of vulnerable consumers, especially if their consumption pattern is linked to their vulnerability characteristics or if there are associated barriers to reducing consumption, such as limited financial means to purchase more energy efficient appliances. Moreover, a uniform rebate might not be cost reflective and could harm efficient suppliers who had a high number of vulnerable consumers.

## **Conclusion**

- 3.39 There are a limited number of options which would achieve our main objective of offering financial protection to vulnerable consumers as quickly as possible, whilst meeting our other objectives. Our analysis suggests that a vulnerable customer safeguard tariff would be the most effective option to meet all these objectives.

## 4. Our options for acting quickly

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### Chapter Summary

In this chapter we explain why we have concluded that we need to provide protections to vulnerable customers this winter, including the scope of our proposals.

- 4.1 As set out in Chapter 2, the evidence on consumer engagement clearly suggests that vulnerable consumers are less likely to engage with the market and be on a more expensive Standard Variable Tariff (SVT). This group is more likely than most to suffer detriment as a result, but affordable energy is particularly important to those who are on lower incomes and may face hardship from paying high prices.
- 4.2 It is our view that taking action to protect vulnerable consumers would be consistent with our statutory objective of protecting the interests of existing and future energy consumers, and our general duties to have regard to the interests of certain groups who are vulnerable and to consider protecting the interests of consumers via means other than the promotion of competition.<sup>44</sup>
- 4.3 As vulnerable consumers are generally more likely to be disengaged than a typical consumer, it is likely that the CMA remedies, any future price protections and our own measures to improve engagement levels will take longer to have their desired effect for this group of consumers. In instances where a consumer's vulnerable circumstances or characteristics are more intractable (for example, consumers who cannot easily access or use the internet, or consumers who have learning difficulties), it could be the case that measures to improve engagement will never be effective.
- 4.4 While we will work with the government on its plans for a price cap for customers on SVTs and other default tariffs.
- 4.5 One of our key objectives is to address the detriment suffered by vulnerable consumers as quickly as possible. Delaying implementation, even by a few months, would mean that eligible consumers will continue to incur significant detriment. Swift intervention is particularly appropriate given the significant price rises announced by a number of suppliers over the past year.
- 4.6 Moreover, the immediate impact may be particularly noticeable during winter. Consumption is typically higher in winter, and so consumers would incur a greater benefit in the first couple of months from being charged a lower rate. This could reduce the chances of a consumer getting into energy debt problems. The impact may not only be financial. Being on high-priced tariffs has a greater impact on vulnerable consumers because they tend to spend a greater proportion

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<sup>44</sup> We may also have regard to the interests of other groups of consumers.

of their income on energy. The situation is particularly bad in winter, when some cannot afford to properly heat their homes. The temporary safeguard tariff may give consumers the ability to afford more heating, with consequent benefits to their health and social well-being.<sup>45</sup>

- 4.7 We think that the best and only option to achieve our objectives is to implement a vulnerable customer safeguard tariff based on the methodology used to set the prepayment safeguard tariff.
- 4.8 We also note that we are not proposing to change any of the absolute values used to calculate the prepayment methodology. Subsequently, we will be using the same cap level as calculated by the prepayment methodology at present.
- 4.9 We recognise that there are alternative options for protecting vulnerable consumers, including variations on the safeguard tariff. But all of these options would involve working through the necessary design considerations with stakeholders, calculating a revised safeguard tariff level, and giving suppliers sufficient notice of our intentions. All of the alternatives would take additional time to implement, but vulnerable consumers are suffering detriment now. Therefore, we have prioritised options which facilitated an immediate intervention.

## Consumers in scope

- 4.10 As we explained in Chapter 2, we want to protect vulnerable consumers who have difficulty in engaging in the market. However, we noted that there is no easy or perfect way of identifying this group of consumers. We look at each component in turn below.
- 4.11 Our consumer vulnerability strategy defines vulnerability as “when a consumer’s personal circumstances and characteristics combine with aspects of the market to create situations where he or she is:
- Significantly less able than a typical consumer to protect or represent his or her interests in the energy market; and/or
  - Significantly more likely than a typical consumer to suffer detriment, or that detriment is likely to be more substantial”.<sup>46</sup>

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<sup>45</sup> To the extent that consumers increase their consumption following the introduction of the vulnerable customer safeguard tariff, this would offset any bill savings.

<sup>46</sup> Ofgem (2013), Consumer Vulnerability Strategy, paragraph 3.4.

<https://www.ofgem.gov.uk/ofgem-publications/75550/consumer-vulnerability-strategy-pdf>

- 4.12 To create a definition for a vulnerable customer safeguard tariff, we need to find suitable indicators which can be used to identify consumers who are vulnerable and have difficulty engaging in the market.
- Receipt of an income-related government benefit could be a reasonable proxy for fuel poverty. Individuals with low incomes are likely to spend a higher proportion of their income on fuel than a typical consumer. We recognise that this does not capture those who are fuel poor due to higher usage.
  - Receipt of a disability-related government benefit may help to identify other vulnerable consumers. As outlined in Chapter 2, analysis from the Energy Market Investigation and Ofgem’s recent Consumer Engagement Survey has also identified links between those living with a disability and vulnerability.
  - As we also stated in the Chapter 2, our concern around disengagement is that the consumer is likely to be on a high-priced SVT. We therefore consider being on a default tariff as a strong indicator of a lack of engagement in practice by the consumer.
- 4.13 We also believe the protection should apply automatically for eligible consumers, rather than requiring consumers to request it. It is likely that some of the most vulnerable consumers would be some of the least likely to contact their supplier.
- 4.14 Suppliers currently have two sets of information that relate to vulnerable consumers:
- The Warm Home Discount (WHD),<sup>47</sup> which suppliers provide on behalf of government, supports potentially fuel poor consumers with energy costs because they receive particular income-related benefits.
  - A Priority Service Register (PSR) maintained by each supplier, which enables vulnerable customers<sup>48</sup> access to free services such as priority support in an emergency, personalised customer services and accessible information.
- 4.15 Both of these sets of information have weaknesses from the perspective of setting the scope for our vulnerable customer safeguard tariff:
- The WHD applies to two groups – a Core Group of consumers receiving the Guarantee Credit element of Pension Credit who receive the WHD automatically, and a Broader Group comprising people who receive certain

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<sup>47</sup> Full information on WHD can be found here:

<https://www.ofgem.gov.uk/environmental-programmes/warm-home-discount-whd>

<sup>48</sup> People of pensionable age; are disabled or chronically sick; have a long-term medical condition; have a hearing or visual impairment or additional communication needs; or are otherwise in a vulnerable situation. (Standard Licence Condition 26).

other benefit payments (or who meet additional supplier-specific eligibility criteria), and who apply for WHD. The funding for Broader Group rebates is limited, and these rebates are paid on a first-come, first-served basis. Consumers in the Core Group are less likely to be in the poorest three income deciles than consumers eligible for the Broader Group<sup>49</sup>, who may not receive WHD because the budget for rebates is capped. The government is considering whether to reform the scheme to make it more targeted.

- In addition, WHD recipients only make up a proportion of those who could be considered vulnerable based on our indicators set out above. Based on the CMA's survey, there are around 1.7m WHD recipients on SVTs (including both prepayment and non-prepayment consumers)<sup>50</sup>, whereas we estimate that there may be around 5.6m households on SVTs containing at least one individual in receipt of income or disability-related benefits.<sup>51</sup>
- Consumers have to agree to be placed on the PSR, which may indicate at least some degree of engagement with their energy supplier by those who are included. The CMA's survey found that consumers on the PSR were less likely than average to be on an SVT – though in some cases suppliers took steps to encourage PSR customers to move onto more favourable tariffs.<sup>52</sup> (We also note that the PSR definition has changed since the CMA's survey was carried out). The PSR is focussed on whether customers require priority services, rather than on whether they have low incomes. As this PSR information is collected by individual suppliers, there may be some differences between them.

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<sup>49</sup> Income deciles based on After Housing Cost Equivalised Income. BEIS (2016), Warm Home Discount: Extension to 2016/17 and 2017/18, IA No: DECC0210, table A1.2

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/531163/Warm\\_Home\\_Discount\\_2016-18\\_extension\\_Final\\_IA\\_23\\_06\\_2016.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/531163/Warm_Home_Discount_2016-18_extension_Final_IA_23_06_2016.pdf)

<sup>50</sup> Percentage of WHD consumers on SVTs from: CMA (2016), Energy market investigation – final report, appendix 9.1, figure 41.

<https://assets.publishing.service.gov.uk/media/576bcbbc40f0b652dd0000b0/appendix-9-1-cma-domestic-customer-survey-results-fr.pdf>

Total number of rebates for 2015/16 WHD Scheme year from: Ofgem (2016) Warm Home Discount annual report 2015-16, paragraphs 3.4 and 4.7.

[https://www.ofgem.gov.uk/system/files/docs/2016/12/whd\\_annual\\_report\\_sy5\\_final\\_for\\_publication2.pdf](https://www.ofgem.gov.uk/system/files/docs/2016/12/whd_annual_report_sy5_final_for_publication2.pdf)

<sup>51</sup> DWP data for the volume of recipients of each combination of benefits was used to estimate the volume of unique individuals in receipt of income or disability-related benefit (excluding the state pension). We assumed that 70% of these individuals are on an SVT, and that an average of 1.3 benefits recipients live in each eligible household. Those in receipt of only HMRC administered benefits such as Tax Credits and Child Benefit are also not included in these estimates.

<sup>52</sup> CMA (2016) Energy market investigation – final report, paragraphs 9.14 to 9.16

<https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>

## Vulnerable Customer Safeguard Tariff Scope

- 4.16 For the temporary safeguard tariff in February, there is not enough time for suppliers to obtain more data than they already have for WHD purposes. We propose that, once customers have been identified by suppliers for WHD purposes, the established status of the customer would be the basis for identifying customers for the purposes of the vulnerable customer safeguard tariff.<sup>53</sup>
- 4.17 **Therefore we propose to apply the vulnerable customer safeguard tariff to existing WHD recipients (in either the Core Group or the Broader Group).**
- 4.18 There are over 2m WHD recipients.<sup>54</sup> Of these, we estimate that around 1m are non-prepayment consumers on SVTs, who would therefore directly benefit from lower prices as a result of the temporary safeguard tariff.
- 4.19 As flagged above, we recognise that the WHD scheme does not target all the customers we would like to protect. However, though this is not perfect, a vulnerable customer safeguard tariff for these consumers would still provide protection for people who are already targeted as fuel-poor. Any larger group would still be likely to include these consumers. We believe that protecting a smaller group sooner is better than waiting until we can protect a larger group.

## Suppliers in scope

- 4.20 In principle, we consider that eligibility for the temporary safeguard tariff should not depend on whether a consumer's supplier is in scope, as this would result in similar consumers with different suppliers being protected or not.<sup>55</sup> We want to ensure that eligible consumers do not lose out.
- 4.21 Our position on which suppliers are in scope is set out in the statutory consultation letter.

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<sup>53</sup> For the avoidance of doubt, the temporary safeguard tariff would not affect a consumer's eligibility for WHD. We consider any impacts on the WHD scheme in Chapter 5.

<sup>54</sup> Ofgem (2016) Warm Home Discount Annual Report 2015-16, paragraphs 3.4 and 4.7. [https://www.ofgem.gov.uk/system/files/docs/2016/12/whd\\_annual\\_report\\_sy5\\_final\\_for\\_publication2.pdf](https://www.ofgem.gov.uk/system/files/docs/2016/12/whd_annual_report_sy5_final_for_publication2.pdf)

<sup>55</sup> We propose that the consumers in scope would be WHD recipients. This will mean that some consumers will be eligible based on supplier-specific eligibility criteria for the WHD Broader Group. Therefore, there will be some unavoidable differences in protection for similar consumers with different suppliers.

## Other scope issues

- 4.22 The statutory consultation letter summarises our proposals on which tariffs would be in scope, and on the treatment of consumers with fully interoperable smart meters.

### Single fuel gas consumers

- 4.23 WHD is paid by electricity suppliers. A consumer may have different suppliers for gas and electricity. In this case, the supplier for a single fuel gas consumer will not know that a consumer receives WHD. The consumer would therefore have the temporary safeguard tariff applied by its electricity supplier, but not by its gas supplier. We estimate that there are around 0.1m consumers in this situation.<sup>56</sup>
- 4.24 Our policy intention would be for all eligible consumers to receive the temporary safeguard tariff for each fuel. However, in the time available for this winter, we have to rely on the data that suppliers already hold. We urge WHD Compulsory Suppliers, especially those with large numbers of single fuel gas customers, to pay particular attention to their treatment of single fuel gas customers.

### Time-period of the vulnerable customer safeguard tariff

- 4.25 This proposal is designed to provide temporary protection. As a result, we are proposing the temporary safeguard tariff remains in place no longer than December 2019 and will fall away once the government's default safeguard tariff is in place. The vulnerable customer safeguard tariff could be removed<sup>57</sup> or amended earlier if we think it is appropriate to do so. This should provide sufficient time for the government to implement its plans for a broader price cap intervention.

## Conclusion

- 4.26 We think that the benefits of our temporary measure will outweigh any shortcomings in the scope and tariff design. Delaying implementation of the temporary safeguard tariff for a number of months would mean that eligible consumers will continue to incur significant detriment.
- 4.27 Our analysis of the impact of the proposed temporary safeguard tariff shows that an estimated 910,000 consumers will see an immediate reduction in their bills by

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<sup>56</sup> Ofgem analysis. Assumes that WHD recipients on SVTs have the same likelihood of being a single fuel gas customer as the population as a whole.

<sup>57</sup> Removing the protections earlier could be achieved by changing the date of the sunset clause. This would not require a licence modification.



a total of around £100 million per year – an average saving of £110 per eligible customer per year.<sup>58</sup> (The average saving will be higher for dual fuel customers and lower for single fuel electricity customers).

- 4.28 For example, if implementation was delayed for six months, and assuming that these months were representative of consumption through the year, we estimate that consumers who would have been eligible for protection from the temporary safeguard tariff would end up paying around £50m more.<sup>59</sup> Swift intervention is particularly appropriate given the significant price rises announced by a number of suppliers over the past year.
- 4.29 Not all consumers who are at risk of vulnerability will be protected under the temporary measure, and whilst they remain outside of the scope of the temporary safeguard tariff they will be exposed to changes in the prices of unregulated tariffs. We will mitigate this as soon as we can, by working with the government to implement its proposals as quickly as possible. While as a contingency, the vulnerable customer safeguard tariff could be removed<sup>60</sup> or amended earlier if we think it is appropriate to do so. This should provide sufficient time for the government to implement its plans for a broader price cap intervention.

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<sup>58</sup> Our approach to these estimates and the assumptions used is explained in Annex B.

<sup>59</sup> We explain our calculation in Chapter 5 and in greater detail in Annex B.

<sup>60</sup> Removing the protections earlier could be achieved by changing the date of the sunset clause. This would not require a licence modification.

## 5. Impact assessment for the temporary safeguard tariff

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### Chapter Summary

This is an impact assessment for our proposed temporary safeguard tariff.

### Context

- 5.1 In this chapter we assess the impacts of the temporary safeguard tariff measure for consumers, suppliers and wider areas of the economy. Our proposals involve the temporary extension of the prepayment safeguard tariff to cover all of those receiving a rebate under the WHD programme in the current or previous scheme year.
- 5.2 We start by assessing the impacts of our proposal on those vulnerable energy consumers who would be eligible for protection. Based on quantitative and qualitative analysis, we assess how likely our proposals are to mitigate the significant detriment experienced by vulnerable consumers, whilst meeting our other objectives to act quickly, complement our wider reforms and minimise market distortion.
- 5.3 Second, we consider the impacts of our proposed measure on domestic suppliers, including possible impacts on pricing to other consumers, revenues and the companies' wider incentives. Finally, we also consider the impacts on other businesses and the wider economic, market and environmental impacts of our proposals.

### Impacts of temporary safeguard tariff on eligible consumers

#### Impact of the temporary safeguard tariff on eligible consumers' bills

- 5.4 We expect our proposals to directly reduce bills for around 0.91 million households. Our proposals, in combination with the prepayment safeguard tariff, will then provide wider indirect protection to all 2.19 million households receiving WHD through the Core and Broader Groups.<sup>61</sup>
- 5.5 Around 0.77 million of the 2.2 million households within the Core and Broader Groups have seen bill reductions from the prepayment safeguard tariff already. Around a further 0.51 million are non-prepayment consumers on fixed tariffs, and will not see reductions in bills. But they will be indirectly protected in the event that they reach the end of their fixed tariff (and so roll onto an SVT), switch from prepayment to another

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<sup>61</sup> Based on estimates of the total number of WHD rebates paid in the 2015/16 scheme year, from the 11 obligated suppliers at that time. We note that there are now additional obligated suppliers.

payment method, or move to a smart prepayment tariff not covered by the existing prepayment safeguard tariff.

- 5.6 These estimates are subject to some uncertainty as they are based on assumptions around the WHD customer base. We firstly identified the overall number of WHD Core and Broader Group rebates within the 2015/16 scheme year. Using CMA survey estimates, we then isolated the number of these households not using prepayment meters. Evidence shows vulnerable customers are more likely to be on prepayment meters. We then estimated the likelihood that these remaining WHD non-prepayment households would be on an SVT.
- 5.7 Our estimates are likely to understate the true number of households benefiting from the temporary safeguard tariff, as they relate only to a single scheme year – whereas the temporary safeguard tariff will provide protection to customers that received the rebate in either the current or previous scheme year.
- 5.8 The majority of customers in receipt of the WHD are likely to receive it in consecutive scheme years, especially those within the automatically allocated Core Group. But we expect a proportion, particularly within the Broader Group to interchange annually. We do not estimate this to be significant, as we might expect those who registered for the Broader Group in a previous year to register quickly. But we are mindful that our assessment is likely to underestimate those impacted. Annex B provides more information about our methodology.

**TABLE 1: Summary of direct impact of temporary safeguard tariff on eligible customers<sup>62</sup>**

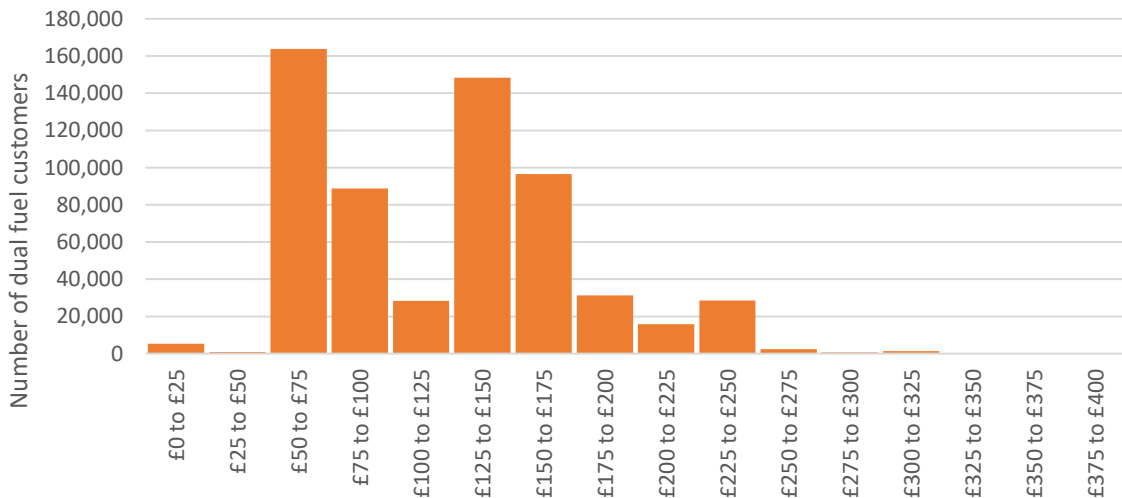
Total number of households protected (directly or indirectly)	2.19 million
Total number of households seeing immediate reduction in bills	0.91 million
Average saving per eligible dual fuel customer per year	£122.25
Average saving per eligible single fuel electricity customer per year	£85.41
Average among all those saving (£ per customer per year)	£110.18
Total reduction in bills per year	£100.3 million

<sup>62</sup> Notes:

1. Total number of households protected based on number of customers receiving WHD rebates in scheme year 2015/16, from the 11 obligated suppliers at this time.
2. Total number of households seeing immediate reductions in bills calculated as set out paragraph 5.5.
3. Average savings calculated by dividing the total saving for the relevant group of non-prepayment WHD recipients on SVTs (dual fuel customers, single fuel electricity customers, or all customers) by the number of customers in that group.
4. Total reduction in bills calculated as set out in annex B.

- 5.9 There will be large differences in the scale of the reduction in bills that a customer protected by the temporary safeguard tariff might expect to see, depending on what tariff they are on, which supplier they are with, whether they pay via direct debit or standard credit, and various other factors.
- 5.10 Based on a comparison of current prices and the level of the prepayment safeguard tariff that applies from 1 October 2017, we estimate that the average reduction in bills per dual fuel customer per year would be equal to around £122, based on a typical level of consumption. (This is approximately 10% of a typical bill for a SVT customer). However, Figure 1 shows that reductions for dual fuel customers could vary from less than £25 for those customers which are already on relatively cheap SVTs, up to over £300 for those customers on the most expensive SVTs in the market.

**FIGURE 1: Distribution of the estimated reduction in annual bills delivered by the temporary safeguard tariff – dual fuel<sup>63</sup>**



- 5.11 Note that all these annualised estimates are based on our medium typical domestic consumption values (TDCVs).<sup>64</sup> As the temporary safeguard tariff is applied on a proportional basis based on the consumption of each household, actual savings will subsequently vary depending on how much energy a customer uses. Some may save more if they use particularly

<sup>63</sup> Saving per dual fuel customer per year based on a comparison of prices as of 28 August 2017 with the level of the prepayment safeguard tariff that will apply from 1 October. It is calculated for a typical level of annual consumption (as applicable from 1 October), and reflects a mixture of direct debit and standard credit, single rate and economy 7 customers.

<sup>64</sup> For a description of what these values are, and how they are calculated – see: <https://www.ofgem.gov.uk/gas/retail-market/monitoring-data-and-statistics/typical-domestic-consumption-values>. Note that the most recent TDCV values are used for the purposes of calculating these estimates – 3,100kWh and 4,200kWh of electricity per year for a profile class 1 and profile class 2 customer respectively, and 12,000kWh of gas.

large amounts of energy (and conversely, will save less if their consumption is low).

- 5.12 Similarly, the estimates above are based on GB average prices. In practice, the level of the temporary safeguard tariff will vary between regions, in line with variations in network costs. However, network cost variations would also influence the level of consumers' current tariffs, and so any impact on the savings figures should be limited.
- 5.13 Some customers may also find themselves in a situation where they roll-off the temporary safeguard tariff in April 2018 after the current WHD scheme year ends (i.e. if they received a WHD rebate in scheme year 2016/17, but have not done so in 2017/18). These customers would therefore only receive savings for a shorter period.
- 5.14 Any financial benefits from the temporary safeguard tariff will also be in addition to the £140 rebate provided to WHD recipients. There will therefore be a significant difference in energy bills between consumers who receive WHD, and those who are eligible for the WHD Broader Group but do not receive a rebate. However, with the data currently available to suppliers, it is not possible to address by this winter.
- 5.15 We also note that the difference between SVTs and the cheapest tariffs in the market<sup>65</sup> is around double the value of the £140 rebate – this means that the value of the WHD rebate to consumers eligible for the temporary safeguard tariff is currently being more than offset by the impact of paying expensive default tariffs. We therefore do not consider that the cumulative effect of the WHD rebate and the temporary safeguard tariff is disproportionate. We also note that the WHD is primarily aimed at helping customers with energy affordability, with one of its main goals being to help customers heat their homes.

### **Impact of the temporary safeguard tariff on eligible customers' engagement**

- 5.16 We are encouraged by signs that engagement in the market is improving and are mindful of any negative indirect impacts of our proposals on levels of consumer engagement for eligible customers. An active customer base is a crucial component of a well-functioning market – the opportunity to win new business (or the threat of losing existing customers) is required to drive suppliers to cut their prices, improve their service and innovate.
- 5.17 CMA analysis indicated that WHD recipients, excluding those who prepay for either fuel, had higher gains available when switching, compared to

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<sup>65</sup> The price difference between the average SVT from the six largest suppliers and the cheapest tariff in the market recently reached around £300. This is for a dual fuel customer paying by direct debt, at the medium Typical Domestic Consumption Values. Data from July 2017.

<https://www.ofgem.gov.uk/data-portal/retail-market-indicators>

customers not benefitting from this scheme.<sup>66</sup> The CMA estimated the average gains available from switching for WHD recipients as 20% of their total annual bill payment. This was noted as statistically significant as it compared to a 17% gain for those not in receipt of the WHD.

- 5.18 The introduction of the temporary safeguard tariff is likely to reduce eligible customers' incentives to engage in the market, and to shop around for the best deal. The temporary safeguard tariff will directly reduce the available gains from switching, by narrowing the gap between eligible customers' bills and the cheapest tariffs available in the market.<sup>67</sup> More generally, the introduction of the temporary safeguard tariff is likely to reduce customers' incentives to engage by creating a sense among eligible customers that they are "protected", and so do not need to take any action (despite the fact that the temporary safeguard tariff is unlikely to be the cheapest offer in the market).
- 5.19 While we consider that an effect along these lines is likely, we note that there is already a significant lack of consumer engagement within this customer segment. As shown above, large gains from switching already exist for many customers in receipt of the WHD and this has not to date been sufficient to encourage these customers to shop around and ensure they are not on expensive default tariffs.
- 5.20 The design of the temporary safeguard tariff should help to reduce the risks that some of those eligible customers that would have otherwise engaged are deterred from doing so. In particular, because it includes headroom (3-4%) and a prepayment uplift (despite some eligible customers paying by direct debit), it should allow suppliers to continue to compete beneath the level of the temporary safeguard tariff – and so ensuring some incentives for customers to shop around continue to exist. In this regard, we note that the cheapest direct tariffs on offer in the market are currently around 20% lower than the level of the prepayment safeguard tariff.<sup>68,69</sup>

## Impacts of temporary safeguard tariff on suppliers

### Direct impacts on supplier revenues from eligible customers

- 5.21 By requiring suppliers to reduce prices for eligible customers, the temporary safeguard tariff will lead to a direct reduction in supplier revenues.

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<sup>66</sup> CMA (2016) Energy market investigation – final report, figure 9.2 and paragraph 9.21. <https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>

<sup>67</sup> Although we note that the relationship between gains from switching and engagement is complex.

<sup>68</sup> See our retail indicator "[Prepayment and direct debit prices since January 2016](#)"

<sup>69</sup> We are proposing to adopt the level of the prepayment safeguard tariff for the vulnerable customer safeguard tariff.

- 5.22 The impact across suppliers will vary depending on a combination of:
- a) the number of eligible customers that they supply, and how much energy they use;
  - b) the proportion of these customers which are already protected by the prepayment safeguard tariff or are currently on a fixed term tariff;
  - c) how much above the level of the temporary safeguard tariff these suppliers' current SVTs are; and
  - d) the number of customers using different payment methods and meter types.
- 5.23 We estimate the total reduction in revenues across those suppliers obligated under the WHD scheme to be around £95.5million per year – although note that this annualised figure is based on a number of simplifications<sup>70</sup>, including that all customers use a typical level of gas and electricity<sup>71</sup>.
- 5.24 We expect this to comprise a relatively small part of the total earnings of these suppliers (noting that the total domestic supply earnings before interest and tax of the six large energy companies alone in 2016 were approximately £1 billion)<sup>72</sup>. There will be no direct impact on the earnings of non-obligated suppliers.

### **Indirect impacts on supplier pricing**

- 5.25 There is a risk that suppliers increase prices for other customers and tariffs. This could be in order to cover any of the costs of supplying eligible consumers that are not recovered under the temporary safeguard tariff, or to recoup lost revenue. In addition, a number of fixed tariff customers will flow onto SVTs upon the completion of their contract. Suppliers are likely to take this expected future revenue into account in how they price fixed tariffs. The temporary safeguard tariff will affect the future revenue that suppliers could expect to receive from certain customers, if they would otherwise have moved to an SVT.
- 5.26 This link between the prices of different tariffs may create a risk that suppliers decide to increase the prices of fixed tariffs, to offset lower expected future revenue streams for customers protected under our proposals. We note, however, that competition for customers on fixed term contracts is strong, and so a supplier that followed such an approach would

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<sup>70</sup> Total reduction in bills calculated as set out in Annex B

<sup>71</sup> Saving per dual fuel customer per year based on a comparison of prices as of 28 August 2017 with the level of the prepayment safeguard tariff that will apply from 1 October. It is calculated for a typical level of annual consumption (as applicable from 1 October), and reflects a mixture of direct debit and standard credit, single rate and economy 7 customers.

<sup>72</sup> Based on data from the large suppliers' consolidated segmental statements – see [Understanding the profits of the large energy suppliers](#)

be likely to lose customers to its rivals. The extent to which the safeguard tariff affects the pricing of fixed term contracts may also be limited because of the number of eligible customers, the lower existing rate of engagement among these customers and the subsequent limited impact on a supplier's perceived revenues per customer.

- 5.27 It is also possible that suppliers increase the prices of SVTs to other customers to offset expected revenue decreases from the temporary safeguard tariff, given that SVT customers are less engaged. The level of the temporary safeguard tariff is designed to reflect the costs of an efficient supplier. As set out in paragraph 5.20, it includes headroom (as well as a prepayment uplift). This should allow even suppliers that are less efficient than the benchmark to recover their costs.
- 5.28 Given this, we would not expect suppliers to increase their prices to other consumers in order to offset revenue reductions resulting from the impact of the temporary safeguard tariff – and would hope that any supplier that sought to do so would lose customers to its rivals.

### **Supplier administration costs**

- 5.29 Suppliers already taking part in the WHD scheme have arrangements in place for identifying customers who are eligible for receipt of the WHD. Likewise these suppliers have also been required to implement the prepayment safeguard tariff (like all suppliers). We therefore believe that our proposals would only lead to a marginal increase in administration costs for these suppliers.
- 5.30 We note that any administrative cost impact of our proposals will be limited to the 12 larger suppliers obligated under the scheme, potentially affecting their ability to compete within the market. However, as we expect the incremental administrative costs to be small, we do not foresee any significant impact on the ability of these suppliers to compete. Likewise we note that these suppliers will already be able to benefit from economies of scale within their administrative functions.

### **Wider supplier incentives**

- 5.31 It is possible that suppliers might be incentivised to encourage their customers protected by our proposals to switch to another supplier, if serving any such customers were loss making to that supplier. However, eligible consumers would be able to save money by switching to a tariff priced below the temporary safeguard tariff, so we believe that any increased levels of customer engagement for vulnerable customers resulting from the temporary safeguard tariff would be an unintended benefit of our proposals.
- 5.32 We also note that our proposals could incentivise suppliers to switch customers onto fixed tariffs. This incentive would only exist where a supplier could switch a protected customer onto a fixed tariff that was more expensive than the temporary safeguard tariff. We believe this threat of mis-selling is mitigated (for example) by the requirements under the



Standards of Conduct<sup>73</sup> to identify vulnerable consumers and treat them fairly. We will monitor how suppliers continue to treat vulnerable consumers following implementation.

- 5.33 It is also possible that obligated suppliers could be incentivised to avoid competing for new customers who they believe to be already in receipt of the WHD. This could lead to possible reductions in marketing avenues which target these households, and subsequently lower levels of customer service. However, a supplier would be likely to gain customers on a fixed tariff, which is not covered by the temporary safeguard tariff. Any impact would therefore only occur through the possibility that the consumer would later move onto the temporary safeguard tariff, at the expiry of its fixed tariff. In any event, we do not believe there is likely to be a significant impact on suppliers' incentives, due to the difficulty in identifying whether a potential new customer gained via a particular marketing channel is eligible for WHD. We also note that Condition 22 of the supply license mandates that suppliers must provide an offer of supply to any customer who requests one.

### **Impacts on WHD scheme**

- 5.34 As a means of capturing vulnerable customers our intention is that the temporary safeguard tariff would cover customers which, in respect of the current or previous WHD Scheme Year, are identified as Core Group or Broader Group customers by obligated suppliers. However, this may create incentives for these suppliers to change their behaviour in terms of to how they administer rebates under the WHD scheme.
- 5.35 For example, it might encourage suppliers to delay accepting applications for Broader Group customers until later in the year, in order to reduce the length of time such customers are subject to the safeguard tariff, and discourage suppliers from exceeding their obligations under the scheme.
- 5.36 While we consider this to be a risk, we note that the scheme rules set out the suppliers' obligations and that these should limit some of the discretion which suppliers have to alter their behaviour. These rules are fairly strict in relation to Core Group, but suppliers have more discretion on when they open and close the Broader Group application window. Any risk of delaying the application window is partly mitigated by the fact that consumers who received WHD in the previous scheme year will still be subject to the temporary safeguard tariff.

### **Impacts on customer service and innovation**

- 5.37 We considered the risk that suppliers might reduce levels of innovation, support and product offerings to eligible customers, both from a cost

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<sup>73</sup> The principles-based domestic and non-domestic Standards of Conduct licence conditions are the foundation stones of the supply licences and require that suppliers treat customers fairly. Our August 2017 amendments now require suppliers to enable consumers to make informed choices and to have special regard for consumers in vulnerable situations.

saving perspective and to potentially limit their attractiveness to particular customer groups who might be eligible under the temporary safeguard tariff.

- 5.38 As set out above, we believe the proposed level of the temporary safeguard tariff should allow efficient suppliers to make a return, and so to fund innovation and improvements in customer service, which will benefit existing and future consumers. We also note that because the customers covered by the temporary safeguard tariff make up a relatively small part of these suppliers' overall customer base, the impact on suppliers' overall incentives to innovate should be limited.
- 5.39 The safeguard tariff only applies to default tariffs. This should reduce the risk that the safeguard tariff limits suppliers' options to offer innovative tariffs – they will continue to be able to do so in the same way as at present for fixed-term tariffs where consumers make an active choice.
- 5.40 Finally, we note that while the safeguard tariff may reduce incentives for suppliers to innovate in their approach to vulnerable customers, this threat should be mitigated by the requirements under the Standards of Conduct to identify vulnerable consumers and treat them fairly. The broad vulnerability principle is to make it clear that suppliers have a special responsibility to treat vulnerable customers fairly. Its effect is to place an obligation on suppliers to seek to identify domestic customers in vulnerable situations in an appropriate and effective manner. The principle also requires suppliers to respond to these domestic customers in a way that takes into account their vulnerability.

### **Investor perception**

- 5.41 We considered the possibility that the safeguard tariff could have a negative impact on investor perception of domestic energy suppliers, resulting in an increase in their cost of capital.
- 5.42 For example, investors may be uncertain as to whether the prepayment methodology reflects suppliers' actual costs and whether this will reduce future profits, their ability to cover the cost of debt and any returns to shareholders. This could blunt incentives to invest in energy suppliers, particularly if the traditional investor base is risk averse. If the cost of capital did increase for energy suppliers, this would ultimately be reflected in efficient prices and result in higher bills for consumers not covered by the temporary safeguard tariff.
- 5.43 However, our analysis suggests that our proposals will have a limited impact on the revenues of the largest suppliers (all of which are large, diversified businesses). This risk is further mitigated by the time-limited nature of our proposals and the methodology, which includes sufficient headroom for efficient suppliers to earn an expected competitive return. Therefore, we do not expect a material impact on the cost of capital for energy suppliers.

### **Wider impacts of the temporary safeguard tariff**

## Impacts on government VAT receipts

- 5.44 Our proposals will lead to an overall reduction in customers' bills per year of around £100.3m. A proportion of this reduction has come from a decrease in the VAT which customers pay on their energy bills. We estimate that VAT receipts will reduce by around £4.8m as an initial result. However, we expect customers to recycle many of these savings back into the economy (potentially including increased energy consumption), meaning that VAT will still ultimately be incurred.<sup>74</sup> Therefore we believe that the overall impact on government VAT receipts will be limited.

## Impacts on third party price comparison websites (PCWs) and other switching services

- 5.45 As described above, the temporary safeguard tariff could reduce the savings available from switching for eligible vulnerable customers. This could lead to fewer eligible vulnerable consumers looking to change supplier, and so a reduction in the commission earned by PCWs and collective switching providers. The scale of this impact will depend on the number of vulnerable consumers in scope, the number who are disincentivised to switch, and the revenue intermediaries receive from these consumers.
- 5.46 We note that the 2.19 million vulnerable customers protected (directly or indirectly) by our temporary safeguard tariff are some of the most disengaged in the market, and are less likely to switch. Those WHD recipients on SVTs who are not likely to have switched recently. Even where WHD recipients do switch, they may be less likely than average to use a PCW. Our consumer engagement survey found that those aged over 65 and in social groups D and E who switched supplier or tariff in the last 12 months were less likely to have compared and/or switched through a PCW.<sup>75</sup> Many WHD recipients will fall into these groups (especially Core Group customers).
- 5.47 Our proposals will primarily limit the gains from switching for a small group of customers, who were already unlikely to engage without significant investment. We could therefore assume that these customers make up only a very small proportion of third party intermediaries' business. As described above, we also believe that the impact of the temporary safeguard tariff on overall switching levels will be marginal. Therefore we estimate only marginal impacts on PCWs and other switching services.

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<sup>74</sup> The precise amounts of VAT paid will partly depend on the extent to which consumers spend more on gas and electricity (5% VAT), goods that are zero-rated for VAT, and goods where the standard 20% rate is charged.

<sup>75</sup> GfK (2017) Consumer engagement in the energy market 2017. Report on a survey of energy consumers. Research conducted on behalf of Ofgem. Page 65.  
[https://www.ofgem.gov.uk/system/files/docs/2017/09/consumer\\_engagement\\_survey\\_2017\\_report.pdf](https://www.ofgem.gov.uk/system/files/docs/2017/09/consumer_engagement_survey_2017_report.pdf)

## **Government and regulator administration costs**

- 5.48 With any intervention, Ofgem would incur some costs from developing, implementing and monitoring a temporary safeguard tariff. We view the extension of our proposals as a marginal increase in the administration required for the prepayment safeguard tariff monitoring. We have not estimated these costs but do not foresee these as a significant increase.

## **Price volatility**

- 5.49 We have considered the possibility that our proposals could lead to increased retail price volatility. Introduction of our proposals will see around 0.91m additional customers having their bills updated twice a year, based on (among other things) wholesale prices as observed over the six months prior to the level of the temporary safeguard tariff being set. However we note that this frequency is broadly comparable with the historic frequency of changes to SVTs<sup>76</sup> – although recent changes have been somewhat less frequent. We have therefore concluded that any impacts on price volatility from our proposals would be marginal.

## **Market structure**

- 5.50 In theory, intervention could lead to changes in the number of small and mid-level challenger suppliers. Changes could come from consolidation within the market, a reduced level of entry from new suppliers and/or existing suppliers exiting the market all together.
- 5.51 We continue to observe significant interest from suppliers looking to enter the UK retail supply market. New entrants have announced their intentions to enter despite press speculation around wider price cap remedies. There has also been increased interest from foreign investors which has included a foreign utility acquiring a UK consumer energy supplier.
- 5.52 Our initial proposals have limited the extension of the prepayment safeguard tariff to cover current WHD obligated suppliers, who are generally the largest in the market with over 250,000 customers. Due to the limited impact which the temporary safeguard tariff could have on smaller and medium suppliers, and the significant level of interest we have observed in this market segment, we do not believe our proposals will alter the trend of increased competition within the retail supply market.
- 5.53 The proportionality of our proposals has limited the impacts on the six largest suppliers. We do not foresee any change in their likelihood to compete within UK markets.

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<sup>76</sup> CMA (2016) Energy market investigation – final report, Paragraph 14.254  
<https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>

## Impacts on the level of consumption

- 5.54 Price changes for both eligible and non-eligible customers could lead to changes in overall levels of consumption. The overall change will depend on the number of customers impacted, the size and direction of any price changes and the price elasticity of demand for these customers. We consider that these impacts will be in addition to any changes in consumption stemming from the WHD scheme and other policy initiatives.
- 5.55 For most consumers, price elasticities are low because energy has many characteristics of an essential good. Espey and Espey's (2004) review of 36 existing studies on residential demand found the median estimates for residential electricity price elasticities were -0.28 in the short run, and -0.81 in the long run. For residential gas consumption, Bernstein and Griffin (2005) reported values of -0.2 in the short run and -0.3 in the long run. These estimates suggest that domestic energy demand is not very responsive to price changes in the short run. It does, however, increase over time.
- 5.56 But this may not be the case for all groups of consumers. We have evidence that vulnerable customers are likely to spend a greater proportion of their disposable income on energy, and that in some cases they may ration their energy usage because of financial constraints. With the support of the WHD scheme and the proposed temporary safeguard tariff, these consumers may be able to afford to consume more energy.
- 5.57 This would suggest it is possible that the temporary safeguard tariff in isolation could result in an increase in aggregate domestic energy consumption, but the evidence supports the conclusion that this effect will likely be longer term. It is important to note that increases in consumption may be beneficial for vulnerable consumers, particularly if they were unable to afford an adequate level of energy previously.
- 5.58 Carbon emissions associated with electricity generation are captured within the EU Emissions Trading Scheme (ETS) and capped. Therefore any changes in consumption should not affect emissions or the UK's legally binding energy targets. In addition, due to only marginal increases in the short term levels of consumption, we do not foresee any significant impact on security of supply.

## Questions

### Question on the impact assessment for the vulnerable customer safeguard tariff

**Question 1:** Do you have comments in relation to our impact assessment for the vulnerable customer safeguard tariff?

## 6. Monitoring and evaluation

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### Chapter Summary

This chapter provides an initial discussion of how we will monitor and evaluate the vulnerable customer safeguard tariff.

- 6.1 Our temporary safeguard tariff is intended as a short-term measure. We will take a proportionate approach to monitoring and evaluation, recognising that, over a short period, the potential for indirect impacts may be smaller compared to a remedy which is in place for longer.
- 6.2 The main direct impact will be the change in bills for eligible vulnerable consumers who currently pay more than the temporary safeguard tariff level. This will depend on:
  - **The amount they will pay under the temporary safeguard tariff.** This is simply the level of the safeguard tariff. This is already published as the prepayment safeguard tariff.
  - **The amount they would have paid otherwise.** We already monitor the tariffs available in the market. We will be able to use the SVT prices for consumers outside the scope of the temporary safeguard tariff as the counterfactual (to estimate the amount that eligible consumers would have paid in the absence of the temporary safeguard tariff).<sup>77</sup>
  - **The number of eligible consumers (non-prepayment WHD recipients) with each supplier.** As part of the reporting provision in the licence condition, suppliers must provide us with their number of vulnerable consumers to whom the condition applies.
- 6.3 In addition to monitoring the direct impact of the safeguard tariff, we will be carrying out monitoring for compliance. This will draw on the information available through the reporting from suppliers. We will also cross-check against any other relevant information we hold, such as the number of WHD rebates paid by each supplier.<sup>78</sup>
- 6.4 While we are interested in any impacts on consumer engagement, we do not intend to monitor this in detail. Eligible vulnerable consumers only represent a small proportion of the market, and so any changes in switching rates by these consumers might not make a noticeable impact

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<sup>77</sup> This assumes that the safeguard tariff would not affect SVT prices for non-eligible consumers. We consider this risk in Chapter 5

<sup>78</sup> An obligated supplier's number of eligible customers is highly likely to be greater than the number of WHD rebates it pays in a given scheme year. This is because a customer is eligible for the vulnerable customer safeguard tariff if they received a rebate in the current or the previous WHD scheme year.

on the overall switching rates that we monitor. We would therefore need to carry out bottom-up analysis to look specifically at the consumers in scope. This would require a baseline for the level of engagement by eligible consumers before the temporary safeguard tariff (based on a proxy measure, such as rates of external switching). We would then need to collect data showing how this changed over time. We would also need to take into account overall trends in switching when interpreting the data. Although it could be possible to gather this information through a request for information to suppliers, because of the transitional nature of and the limited estimated impact, we do not intend to carry this out.

- 6.5 We will pay attention to market developments as part of our ongoing general market monitoring – this will allow us to follow any significant wider impacts resulting from the temporary safeguard tariff.

## 7. Annex A: Description of the prepayment methodology

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### Introduction

- 7.1 The prepayment safeguard tariff came into force on 1 April 2017. Although the licence condition was introduced by the CMA, we have responsibility for updating the level of the prepayment safeguard tariff. This is based on a methodology specified in the licence condition.
- 7.2 The prepayment safeguard tariff applies to all customers with prepayment meters, except those with fully interoperable smart meters. The prepayment safeguard tariff applies to all tariffs, whether these are fixed or variable.
- 7.3 The prepayment methodology sets the prepayment safeguard tariff at different levels for gas, standard electricity and Economy 7 electricity customers in each of the 14 electricity network charging regions (a total of 42 safeguard tariff levels for each period). The safeguard tariff defines a maximum amount that can be charged to prepayment customers for any given level of consumption.
- 7.4 The level of the safeguard tariff is updated every six months, on 1 April and 1 October. We publish the revised levels of the safeguard tariff approximately two months in advance. Table 2 shows the breakdown of the prepayment safeguard tariff that applies for the period 1 October 2017 to 31 March 2018.



**Table 2: Breakdown of the prepayment safeguard tariff, 1 October 2017 – 31 March 2018<sup>79,80,81</sup>**

	Electricity (single rate)	Gas	Electricity (economy 7)	Dual fuel (with single rate electricity)
Competitive benchmark	£327.86	£304.41	£380.19	£632.27
Payment method cost uplift	£24.74	£40.21	£24.74	£64.95
Headroom	£14.92	£11.99	£13.81	£26.91
Network allowance (GB average)	£135.58	£122.46	£141.86	£258.05
Safeguard tariff (excluding VAT)	£503.10	£479.07	£560.59	£982.17
<b>Safeguard tariff (including VAT)</b>	<b>£528.26</b>	<b>£503.02</b>	<b>£588.62</b>	<b>£1,031.28</b>

Source: Ofgem calculations.

## Benchmark, payment method uplift and network charges

- 7.5 The competitive benchmark for the prepayment methodology is based on the average direct debit price of two mid-tier suppliers in 2015. The CMA collected information to estimate the average prices of these suppliers.
- 7.6 The CMA made a number of adjustments to the average prices of these two suppliers, to ensure the benchmark was comparable to the prices of other suppliers, including larger suppliers. These comprised adjustments to allow for:
- the difference in the costs these suppliers incurred in relation to social and environmental programs as a result of their smaller size;
  - a standardised approach to the amortisation of customer acquisition costs;
  - the level of overhead costs that would be expected for a company that was neither growing nor shrinking;
  - removing the network cost element, to account for cost differences due to regional distribution of customers; and

<sup>79</sup> A separate safeguard tariff is not published for dual fuel – the values in the final column are derived by summing the values for electricity (single rate) and gas.

<sup>80</sup> Level of the safeguard tariff is expressed for current medium Typical Domestic Consumption Values (TDCVs). These are: 3,100kWh for single-rate electricity, 4,200kWh for Economy 7 electricity, and 12,000kWh for gas. We recently amended the TDCVs with effect from 1 October 2017 – these are the latest values.

<sup>81</sup> Network component is a simple average across the 14 electricity distribution regions.

- finally, a return (i.e. an average EBIT margin) of 1.25%.
- 7.7 The prepayment methodology includes separate benchmarks for a gas consumer, a single rate electricity consumer and an Economy 7 electricity consumer.
- 7.8 The benchmark at nil consumption was set in a different way.
- 7.9 The benchmark was not specific to prepayment customers. The analysis was carried out for a gas or electricity consumer paying by direct debit, and the competitive benchmark was then uplifted to allow for the additional costs the CMA estimated a supplier would incur in serving a prepayment customer. Table 3 sets out the values of these cost uplifts – and those for a customer paying by standard credit.<sup>82</sup>

**Table 3: CMA estimates of payment method cost differentials**

	Premium to direct debit	
	Range	Central estimate
<b>Prepayment</b>		
- Electricity	£19-£33	£24
- Gas	£31-£48	£39
- Dual fuel	£50-£81	£63
<b>Standard credit</b>		
- Electricity	£39-£69	£47
- Gas	£45-£81	£53
- Dual fuel	£84-£150	£100

Source: Information from appendix 9.8 to the CMA’s final report.

- 7.10 The CMA’s benchmarks exclude costs resulting from network charges. This reflects that these costs will depend heavily on a supplier’s mix of customers (with charges varying by region and meter type). This component of prices was estimated by combining published network charges with assumptions around consumption, load factors and other variables which influence the amount a supplier is charged.

## Headroom

- 7.11 The prepayment methodology includes a headroom level of 4.23% for electricity and 3.48% for gas, fixed across all suppliers. This percentage is applied to all elements of costs except the network allowance. It therefore scales with consumption, and will vary over time according to movements

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<sup>82</sup> Full details of the CMA’s estimates are provided in appendix 9.8 to the CMA’s final report. CMA (2016) Energy market investigation – final report, appendix 9.8 <https://assets.publishing.service.gov.uk/media/576bcc08ed915d3cfd0000b9/appendix-9-8-analysis-of-costs-by-payment-method-fr.pdf>

in the cost indices. The percentages were intended to deliver around a £30 headroom for a dual fuel prepayment consumer with typical consumption.

- 7.12 In setting this level of headroom the CMA took into account the impacts on customers and suppliers, through: the reduction in detriment for prepayment consumers, the impact on profitability for suppliers, and the effect on competition.<sup>83</sup>
- 7.13 The chosen level of headroom was expected to result in around two-thirds of prepayment customer detriment being reduced for customers with each fuel/meter combination, and a greater proportion of detriment being reduced in some cases.<sup>84</sup> At most, almost 100% of the detriment was expected to be addressed for single fuel gas customers with single rate meters.<sup>85</sup> The chosen level of headroom was expected to generate an average saving of £71 per customer.<sup>86</sup>
- 7.14 For a hypothetical supplier, a zero headroom level under the prepayment methodology would have covered efficient costs and allowed for a 1.25% EBIT margin for the supplier's single fuel prepayment tariffs. Including headroom increased the weighted average EBIT margin across all tariff types to around 5% at medium TDCV (for an efficient supplier). This margin was in line with the large suppliers' views on a reasonable competitive margin for retail supply.<sup>87</sup>

## Updating the safeguard tariff

- 7.15 Under the prepayment methodology, we update the level of the prepayment safeguard tariff twice a year. The two periods run from 1 April to 30 September and from 1 October to 31 March. We publish the levels of the safeguard tariff around two months before the start of each period.
- 7.16 The level of the prepayment safeguard tariff is set according to developments in a series of cost indices. Different indices are used to

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<sup>83</sup> CMA (2016), Energy market investigation – final report, paragraph 14.251  
<https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>

<sup>84</sup> CMA (2016), Energy market investigation – final report, paragraph 14.258 and table 14.13  
<https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>

<sup>85</sup> CMA (2016), Energy market investigation – final report, paragraph 14.259  
<https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>

<sup>86</sup> CMA (2016), Energy market investigation – final report, paragraph 14.261  
<https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>

<sup>87</sup> CMA (2016), Energy market investigation – final report, paragraph 14.269  
<https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>

approximate trends in different components of the safeguard tariff – these are set out in tables 4 and 5 below.

- 7.17 In order to apply weights to various indices when updating the competitive benchmark (which covers wholesale, policy and other costs), the prepayment methodology includes an assumption about the proportion of the competitive benchmark which was made up of each cost category.<sup>88</sup>

**Table 4: Indices used to update level of prepayment safeguard tariff – electricity (single rate)**

Element		Indexed using
Competitive benchmark	Wholesale costs	Prices of winter / summer forward contracts covering the Charge Restriction Period, and the subsequent season
	Policy costs	Office for Budget Responsibility forecasts of environmental levies for financial year
	Other	Consumer Price Index (inflation)
Payment method cost uplift (prepayment)		Consumer Price Index (inflation)
Network cost / balancing services component		Charges published by National Grid and electricity distribution network operators

**Table 5: Indices used to update level of prepayment safeguard tariff – gas**

Element		Indexed using
Competitive benchmark	Wholesale costs	Prices of quarterly forward contracts covering the Charge Restriction Period, and the subsequent two quarters
	Policy costs	Consumer Price Index (inflation)
	Other	Consumer Price Index (inflation)
Payment method cost uplift (prepayment)		Consumer Price Index (inflation)
Network cost / balancing services component		Charges published by National Grid and gas distribution companies

<sup>88</sup> CMA (2016), Energy market investigation – final report, table 14.4  
<https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>

## 8. Annex B: Methodology for calculating impact on consumer bills and supplier revenues

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### Number of customers

- 8.1 To estimate the impact of the safeguard tariff, we need to know the number of customers who receive WHD, but who do not have a prepayment meter and who are on an SVT.
- 8.2 We started with the total number of customers in receipt of WHD rebates in scheme year 2015/16, for those 11 obligated suppliers of the Warm Home Discount.<sup>89</sup> We then estimated of the proportion of WHD customers who were both not on prepayment and on an SVT. We did this using information on the proportion of all WHD customers on prepayment,<sup>90</sup> the proportion of all WHD customers on SVTs<sup>91</sup> and the proportion of all prepayment customers on SVTs.<sup>92</sup> This data is not available at the level of each individual supplier and so our analysis assumes that the proportion is the same for each supplier. We applied this estimated proportion to the number of WHD recipients, to give an estimate of the number of non-prepayment WHD customers on SVTs.
- 8.3 To estimate the number of customers in scope with each supplier, we used supplier account information to calculate the individual share of non-prepayment SVT accounts.<sup>93</sup> We then used the supplier's share of non-prepayment SVT accounts to allocate the number of non-prepayment WHD customers on SVTs. (A supplier's WHD obligation is based on its share of all customer accounts, not just its share of SVT customer accounts. However, this approach helps us to take into account where a supplier has a lower than average proportion of customers on SVTs as well as those with a low proportion of their customer base on non-prepayment methods).

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<sup>89</sup> Ofgem (2016) Warm Home Discount annual report 2015-16, paragraphs 3.4 and 4.7. [https://www.ofgem.gov.uk/system/files/docs/2016/12/whd\\_annual\\_report\\_sy5\\_final\\_for\\_publication2.pdf](https://www.ofgem.gov.uk/system/files/docs/2016/12/whd_annual_report_sy5_final_for_publication2.pdf)

<sup>90</sup> CMA (2016), Energy market investigation – final report, appendix 9.1, paragraph 301(h). <https://assets.publishing.service.gov.uk/media/576bcbbc40f0b652dd0000b0/appendix-9-1-cma-domestic-customer-survey-results-fr.pdf>

<sup>91</sup> CMA (2016), Energy market investigation – final report, appendix 9.1, figure 41. <https://assets.publishing.service.gov.uk/media/576bcbbc40f0b652dd0000b0/appendix-9-1-cma-domestic-customer-survey-results-fr.pdf>

<sup>92</sup> Supplier customer account information for April 2017. For the purpose of this analysis, all variable tariffs were treated as SVTs, and each dual fuel customer was counted as two customer accounts.

<sup>93</sup> Supplier customer account information for April 2017.

## Customer savings and impact on supplier revenues

- 8.4 To estimate the total savings on consumer bills, we collected information on tariff unit rates, standing charges and online / dual fuel discounts for all evergreen electricity, gas and economy 7 tariffs offered by the WHD Compulsory Suppliers as of 28 August 2017, which will be the base date for our assessment.<sup>94</sup> For each supplier, we then allocated their estimated number of customers in scope (as calculated in the previous section) between the tariffs they offer.
- 8.5 First, we allocated customers between dual fuel and electricity only accounts,<sup>95</sup> and standard credit and direct debit. We did this using data for each supplier on its split of non-prepayment SVT accounts by account type.<sup>96</sup>
- 8.6 Second, we allocated customers between paper and paperless tariffs using data for each supplier on its split of total accounts by administration type.<sup>97</sup>
- 8.7 Third, we allocated customers between Economy 7 and single rate tariffs using information on the total number of profile class 1 and profile class 2 meter points served by each obligated supplier.<sup>98</sup>
- 8.8 Taken together, this meant that for each tariff, we have an estimate of the number of customers in scope (non-prepayment WHD recipients on SVTs).
- 8.9 The total annual bill for each tariff was calculated based on the current Typical Domestic Consumption Values, as applicable from 1 October 2017. These are 3,100kWh and 4,200kWh of electricity per year (for single rate and Economy 7 respectively) and 12,000kWh of gas per year.
- 8.10 Finally, this annual bill was compared with the level of the prepayment safeguard tariff that will apply from 1 October 2017 to calculate the estimated reduction in bills. Where there would be a reduction in bills on a given tariff under the safeguard tariff, this was multiplied by the number of customers in scope on that tariff. The total customer impact was then the sum of the bill savings on each tariff.
- 8.11 To calculate the impact on supplier revenues we followed the same approach, but excluded VAT.

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<sup>94</sup> This uses data from Energyhelpline.

<sup>95</sup> WHD rebates are only paid to electricity accounts. We therefore did not include gas only accounts in this calculation, because gas only customers will not be WHD recipients.

<sup>96</sup> Supplier customer account information for April 2017.

<sup>97</sup> Supplier customer account information for March 2016

<sup>98</sup> Information provided by Elexon. Based on settlement data from June 2017.

## Assumptions and limitations

- 8.12 Our analysis must use a number of assumptions to estimate the number of consumers benefitting under the temporary safeguard tariff and the total impact on consumer bills.
- 8.13 First, our estimate is based on the market price as of 28 August<sup>99</sup> and the prepayment safeguard tariff that will come into force on 1 October 2017. This is the most appropriate and robust counterfactual that we could adopt given the difficulty in accurately predicting what might happen to prices before the temporary safeguard tariff comes into force, and how the prepayment safeguard tariff might change over the duration of the temporary safeguard tariff.
- 8.14 All other data used is taken from the latest data or estimates available. In some cases the time periods used are not consistent, but we considered that this was the most appropriate and transparent approach.
- 8.15 Second, our estimates are based on a standardised level of annual consumption. Reductions in bills for individual consumers will vary significantly depending on their energy use.
- 8.16 Third, due to the limited data available, our analysis does not directly account for the proportion of each supplier's WHD customers who: are on SVTs, use different payment methods, have single fuel vs direct fuel accounts, administer their accounts online, or have Economy 7 or standard single rate electricity meters. Instead, these proportions are all estimated using data on the WHD recipient group across all suppliers, or data across all customers. Non-Economy 7 restricted meter tariffs are excluded from the analysis, and profile class 2 customers on these tariffs are effectively allocated to Economy 7.
- 8.17 Finally, our estimate for the number of customers in scope is based on a single WHD scheme year (2015/16). This will cause us to underestimate the number of customers covered by the temporary safeguard tariff, as at any time it will cover those receiving WHD both in the previous and current scheme years.
- 8.18 The extent to which this simplification is significant will depend on the degree to which the identity of WHD recipients changes between scheme years. Our understanding is that the identity of WHD Core Group recipients should not change significantly between scheme years, because these customers are pensioners in receipt of the Guarantee Credit element of Pension Credit, and so their circumstances may be less likely to change than other benefit recipients (e.g. those receiving benefits based on employment status). There may be more variability in the identity of WHD Broader Group recipients between scheme years.

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<sup>99</sup> Our data includes information on a price increase by one supplier which had been announced but not implemented on this date.