# Impact Assessment

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## Supplier Guaranteed Standards of Performance for Switching

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|---|---|---|---|
| **Division:** | Retail System Transformation | **Type of measure:** | Retail Competition measures/ |
| **Team:** | Switching Programme | **Type of IA:** | Not Qualified under Section 5A UA 2000 |
| **Associated documents:** | Supplier Guaranteed Standards of Performance: Approach to Impact Assessment on Introducing Switching Compensation | **Contact for enquiries:** | Switching.Compensation@Ofgem.gov.uk |


**Summary:**

In June 2018 we consulted upon new supplier Guaranteed Standards of Performance relating to switching. Our intention was to introduce automatic compensation for consumers when switches go wrong, providing recompense for detriment incurred and creating incentives to ensure suppliers improve their switching performance and make switching more reliable.

Alongside our June consultation we published an Approach to Impact Assessment document, containing our rationale for intervention and an assessment of the options that we considered. This document provides an update of the analysis contained in that document, based on responses to our Request for Information (RfI).

Based on this analysis, subject to a final consultation, we intend to proceed with the introduction of supplier Guaranteed Standards of Performance. This way forward, and a draft statutory instrument, is contained in the Consultation document associated with this impact assessment.

# 1. Responses to the Request for Information and analysis of costs and benefits

**Section summary**

In this section we build on the approach as set out in our Approach to Impact Assessment document to estimate the costs and benefits of implementing our Guaranteed Standards, based on historic switching data and cost data provided in the RfI.

## Impact assessment

1.1. Alongside our June consultation, we published an Approach to Impact Assessment document setting out our approach to calculating the costs and benefits of our proposed Guaranteed Standards.

1.2. The case for intervention is set out in Chapter One of that document and we have not reproduced it here.[1] The Approach to Impact Assessment document explained the rationale for calculating the likely costs and benefits of our proposals and should be read alongside this document.

### Methodology for calculating costs and benefits

1.3. We have elected to use a static model of the direct costs and benefits of the introduction of new Guaranteed Standards in order to assess their expected costs and benefits. This static model is based on a snapshot of suppliers' performance in delivering reliable switching in the last calendar year for which data is available (2017) and data on fixed and variable costs returned by suppliers.

1.4. As indicated in our Approach to Impact Assessment document, we have not attempted to model the dynamic effects of changes to energy switching on benefits in future years, including:

- the net present value of future benefits or costs directly incurred as a result of the implementation of new Guaranteed Standards;
- the impact of new Guaranteed Standards in changing the incentives on firms to reduce the number of delayed or erroneous switches; or

[1] See "Supplier Guaranteed Standards of Performance: Approach to Impact Assessment on Introducing Switching Compensation" at https://www.ofgem.gov.uk/system/files/docs/2018/06/supplier_guaranteed_standards_of_performance_approach_to_impact_assessment_on_introducing_switching_compensation_for_publn.pdf, pp6-12

- the impact of other programmes upon the reliability of switching going forward (such as Ofgem's Faster and More Reliable Switching Programme and the associated data improvement work).[2]

1.5. We expect that the Faster and More Reliable Switching Programme will improve customer outcomes in switching, and that this will make switching energy provider more popular amongst consumers, which in turn is likely to affect the incidence of erroneous and delayed switches. In addition, we would expect the presence of Guaranteed Standards themselves to act as an incentive to improve behaviour, so the incidence of detriment suffered by customers (and therefore the compensation received) will decline in years going forward following their implementation.

1.6. However, we consider it prudent to exclude any impacts of that programme from this analysis, in order to avoid the risks of double counting any benefits arising from this work which have already been accounted for elsewhere. Whilst the expected incidence of detriment events may vary between years, the occurrence of some events (such as erroneous switches) has been stable in recent years.

1.7. As set out in our Approach to Impact Assessment document, we consider that this is a proportionate approach for a policy initiative of this cost and size.

**Calculation of estimated benefits of the proposed Guaranteed Standards**

1.8. Our assessment of the total benefits used in this analysis have been calculated from our own analysis of the expected occurrence of the events that would trigger compensation payments in our Guaranteed Standards, and data returned from our Request for Information (RfI). Where benefits and costs have been calculated based on data taken from supplier responses to the RfI, we have applied an uplift based on the total market share of those suppliers who provided data. The uplift applied to each benefit and cost category is provided in Appendix 3.

1.9. As set out in our Approach to Impact Assessment document, we have considered that the benefit received by customers takes the form of compensation for the time spent contacting suppliers to rectify issues arising from a switch, or the loss of benefits from switching associated with a delayed switch. The methodology for calculating the expected benefit from these transfers is set out in detail in that document.[3]

1.10. The benefits below are calculated based on the expected incidence of the detriment events which cause a payment to be made under the Guaranteed Standards, and the value of the Standard Payment, which will be £30 in most instances.

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[2] This expected dynamic impacts on switching arising from our Switching Programme are outlined in more depth in our Impact Assessment for that programme. See "Delivering Faster and More Reliable Switching: proposed new switching arrangements" at https://www.ofgem.gov.uk/system/files/docs/2017/11/delivering_faster_and_more_reliable_switching_impact_assessment.pdf.

[3] See "Supplier Guaranteed Standards of Performance: Approach to Impact Assessment on Introducing Switching Compensation" at https://www.ofgem.gov.uk/system/files/docs/2018/06/supplier_guaranteed_standards_of_performance_approach_to_impact_assessment_on_introducing_switching_compensation_for_publn.pdf, pp21-24

1.11. In our Approach to Impact Assessment document, we stated our intention to use the Standard Payment as a proxy for a cash value for detriment caused to a customer (and therefore for the benefits accrued to customers from the Guaranteed Standards). We asked stakeholders to provide us with any information that might help us to improve upon this calculation (such as voluntary redress provided to customers for the kind of incident addressed by the Guaranteed Standards).

1.12. The responses received in the RfI were mixed. Some suppliers indicated that they did not provide compensation to customers who had suffered detriment. Other suppliers indicated that the provided compensation on an ex gratia basis, although this varied in value across suppliers. A typical *ex gratia* payment was of 'between £10 and £50', although one supplier did make a standard payment of £20 for delayed switches. Based on these responses, and in the absence of alternative information, we consider that the existing standard payment of £30 is a reasonable proxy for detriment suffered as a result of the failure of suppliers to meet any of these Guaranteed Standards.

1.13. Guaranteed Standard A (as originally drafted) captured delays in returning erroneously switched customers to their old supplier within 21 working days of identification of an erroneous switch, as well as completion of a valid switch within 21 working days. To implement this Guaranteed Standard, we have separated it into two parts, with return of erroneously switched customers being covered by Guaranteed Standard A1, and delayed switches being covered by Guaranteed Standard A. However, in our RfI we did not ask suppliers to differentiate between these aspects of the originally proposed Guaranteed Standard, and as such for the purposes of this analysis, we have considered the expected benefits from both parts together.

1.14. Table 1 below shows an assessment of the annual benefits that we expect to accrue from the Guaranteed Standards. This is based on a static analysis of our estimate of the incidence of the factors triggering a payment in the calendar year 2017. In this table we have considered the benefits of the proposed Guaranteed Standards both as a whole and individually.

1.15. In our consultation associated with this Impact Assessment, we indicate our intention to introduce the Guaranteed Standards in two tranches, with the first tranche being implemented in early 2019 and the second in summer 2019. For the purposes of this analysis, we have considered the Guaranteed Standards as a complete package of measures, and have not distinguished between those that we intend to introduce immediately and those that we would introduce following further development and data analysis in mid-2019.

1.16. We plan to work with industry ahead of introduction of the second tranche of Guaranteed Standards to better target them at the causes of the detriment experienced. We expect this to reduce the risk of unintended consequences and perverse incentives. However, this additional work to establishing the distribution of responsibility for detriment before implementation will not necessarily reduce the amount of compensation paid under the Guaranteed Standards, and therefore we have retained the compensation payments associated with the original proposed Guaranteed Standards for the purposes of this analysis.

1.17. Based on this analysis, we estimate that a total of £73.1 million of benefits would be transferred from suppliers to consumers under this mechanism.

**Table 1: Expected annual benefits accruing from Guaranteed Standards**

| Proposed new performance standard | | Estimated incidence based on 2017 data | Data source | Potential total repayment to customers |
|---|---|---|---|---|
| For immediate implementation | (B) To agree whether a switch is valid or erroneous within 20 working days of identification of the possible erroneous switch. | 44,600 | Taken from supplier data provided in Request for Information | £1.3m (New Supplier) £1.3m (Old Supplier) |
| | (D) To send the Erroneous Transfer Customer Charter "20 working day letter" to an erroneously switched consumer. | 19,580 | Extrapolated from 2017 switching data | £0.6m (Contacted supplier) |
| | (F) To refund credit balances within ten working days of sending the final bill. | 196,900 | Taken from supplier data provided in Request for Information | £5.9m (New Supplier) |
| | (A1) To return an erroneously switched customer within 21 working days of identification of an erroneous switch. | 837,000 | Extrapolated from 2017 switching data | £25.1m (New Supplier) £12.6m (Old Supplier) |
| For implementation in summer 2019 | (A) To ensure a switch is completed within 21 calendar days from the date the consumer enters into contract with gaining supplier unless there are valid reasons for delay to switch | | | |
| | (C) To ensure a consumer is not erroneously switched | 89,000 | Extrapolated from 2017 switching data | £2.7m (New Supplier) £1.3m (Old Supplier) |
| | (E) To issue final bills within six weeks of a switch | 744,000 | Extrapolated from 2017 switching data | £22.3m (Old Supplier) |
| | Total annual incidence/benefit for these measures | 1,867,824 | | £73.1m |

**Calculation of estimated costs of the proposed Guaranteed Standards**

1.18. In our Approach to Impact Assessment document, we outlined that since most of the Guaranteed Standards corresponded to existing requirements of licence conditions, we did not consider that the cost of adhering to those standards should form part of the calculation when assessing the balance of costs and benefits of these processes.

1.19. For this reason, in our RfI we limited the expected additional costs of implementing these Guaranteed Standards to those standards where there is no corresponding licence condition, or where the licence condition differs somewhat from the Guaranteed Standard, and also the cost of maintaining the Guaranteed Standard. These costs are set out in Table 2 below, and are all based on figures returned from our RfI.

1.20. Cost information is taken from data provided by suppliers in response to our RfI.[4] As set out above, we have applied an uplift based on the market share of those suppliers who provided data for each cost category in order to estimate the total market cost. These uplifts are summarised in Appendix 3.

1.21. Supplier responses to our RfI showed a wide variance in expected costs provided by suppliers. Appendix 1 shows the range of costs and average value for each category of cost information requested in our RfI.

1.22. We would expect some variance in the implementation costs of Guaranteed Standards between suppliers. Some costs, such as personnel costs, will be scalable based on the size of a supplier's retail business. However, based on the responses we consider that the wide variance in some costs between similar sized suppliers indicates that there is likely to be room for some suppliers to reduce their costs. For example, one supplier's estimate of the fixed IT and systems cost of updating marketing materials for consumers amounted to £2.1 million of a £2.7 million total for that cost from all respondents answering that question in the RfI (which amounted to 73% of the industry by market share). The basis of this cost included sending notification of the new Guaranteed Standards by post (which was not explicitly required under its terms).

1.23. We have not contested the estimates of cost provided in the RfI by suppliers, and consider that it is prudent to base our assessment of costs and benefits based on these reported costs. However, we consider that the variance exhibited in these costs, including between those costs exhibited by similar sized providers, indicates that the actual cost of implementing these proposals is likely to be lower than that indicated by this estimate, and at least that there is scope for some suppliers to reduce their costs.

1.24. Based on the analysis in Table 2, we estimate that the single-year cost of implementing the Guaranteed Standards will be slightly over £20.9 million, comprising £13.6 million of fixed costs and £7.3 million of variable costs.

**Table 2: Costs of implementing a Guaranteed Standards regime (source: supplier data in Request for Information)**

| Cost category | | Fixed (one-off) costs | | | Variable (annual) costs | | | TOTAL FIRST YEAR COST |
|---|---|---|---|---|---|---|---|---|
| | | People (£000) | IT/ Systems (£000) | TOTAL FIXED (£000) | People (£000) | IT/ Systems (£000) | TOTAL VARIABLE (£000) | |
| 1 | Cost of establishing, or extending a mechanism for implement Guaranteed Standards and compensation | 1,217 | 2,777 | 3,994 | 2,040 | 232 | 2,273 | 6,267 |
| 2 | Expected cost of reporting performance to | 150 | 536 | 686 | 126 | 46 | 172 | 858 |

[4] In total we received 17 responses to our RfI. The majority of these responses came from larger suppliers, for whom responding to certain questions was compulsory.

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Ofgem and Citizens Advice. | | | | | | | |
| 3 | Expected cost of updating marketing and customer facing materials | 218 | 3,757 | 3,975 | 272 | 2,365 | 2,637 | 6,612 |
| | **Total cost of implementing reporting and communicating new standards** | **1,585** | **7,070** | **8,655** | **2,438** | **2,643** | **5,082** | **13,737** |
| 4 | Costs of complying with, and monitoring performance of a requirement to refund credit balances within two weeks of issuing a final bill. | 398 | 1,741 | 2,139 | 1,020 | 145 | 1,164 | 3,303 |
| 5 | Costs of ensuring that a switch is completed within 21 days from the date the consumer enters into contract with gaining supplier, or from date an erroneous switch is agreed, rather than within 21 days of the 'relevant date' | 705 | 2,063 | 2,768 | 858 | 238 | 1,096 | 3,864 |
| | **TOTAL** | **2,688** | **10,874** | **13,562** | **4,316** | **3,026** | **7,342** | **20,904** |

1.25. In common with our approach to calculating benefits, whilst we have attempted to isolate fixed and variable costs of implementing new Guaranteed Standards, we have not modelled the dynamic effect of changes to switching systems and improvements to industry data on this assessment of cost.

1.26. Appendix 2 contains an analysis of the costs and benefits of individual Guaranteed Standards. Since the extent of variable costs will depend on the number of incidences of each of the events which triggers a payment of an individual Guaranteed Standard, we can allocate these costs to individual standards based on the relative volume of occurrence of those events. In addition, some of the cost categories (4 and 5 in Table 2 above) relate to individual Guaranteed Standards. However, disaggregating the fixed costs of introducing individual Guaranteed Standards, rather than as a whole, is challenging. We consider that the fixed cost of implementation would be the same if one or all of the new Guaranteed Standards was introduced, and therefore the fixed costs would be incurred in implementing the first Guaranteed Standard.

1.27. Therefore, we have excluded these fixed costs from our analysis of the cost of implementing individual Guaranteed Standards, since we are not planning to implement

them individually. We note that this remains a significant component of the implementation cost of the Guaranteed Standards in totality.

**Potential cost impact upon customers**

1.28. Some respondents to our consultation argued that suppliers would pass the costs incurred from Guaranteed Standards on to consumers. Suppliers' costs will vary with the extent that they breach the Guaranteed Standards, and the degree of efficiency with which they implement the measures. We would expect competition in the retail energy market to prevent suppliers from passing on these costs to consumers.[5]

**Comparison of costs and benefits**

1.29. Based on this analysis above, it is clear that the estimated aggregate benefits of introducing Guaranteed Standards considerably exceeds the aggregate relevant costs (fixed and variable) that we have identified. Based on this static analysis, we would expect to see £52.2 million worth of benefits in excess of the relevant costs borne by suppliers accruing to customers in the calendar year following implementation.

1.30. For the reasons outlined in our Methodology above, we have not attempted to model the dynamic impacts of changes in the retail market or the effect of improved incentives upon suppliers to avoid causing detriment. However, costs incurred in the implementation of the Guaranteed Standards by incumbent suppliers would not be repeated in future years, and the costs incurred by new entrants might reasonably be expected to be lower. It can be argued, therefore, that if the incidence of detriment remained static or increased (or decreased less than the fixed costs incurred by suppliers in first-year set-up), then the undiscounted net annual benefit accrued by customers would increase in future years.

[5] Fines and exceptional costs have not been included in baseline calculations for the retail price cap. See 'Default Tariff Cap: Decision Appendix 6' — Operating costs at https://www.ofgem.gov.uk/system/files/docs/2018/11/appendix_6_-_operating_costs.pdf, p22.

# Impact Assessment

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## Appendices

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# Appendix 1

## Distribution of cost data from RfI respondents

1.1. This appendix shows the distribution of cost data received from respondents to our RfI. As can be seen from the data below, there was a wide distribution of expected costs for all of these categories. In some instances, suppliers expected that changes could be made to systems at effectively zero cost.

**Table A1: Distribution of cost data from RfI respondents**

| Cost Category (as defined in RfI) | Number of data points received in RfI responses | Fixed (one-off) costs | | | | | | Variable (annual) costs | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | People (£000) | | | IT/Systems (£000) | | | People (£) | | | IT/Systems (£) | | |
| | | Min | Max | Mean | Min | Max | Mean | Min | Max | Mean | Min | Max | Mean |
| Costs of complying with, and monitoring performance of a requirement to refund credit balances within two weeks of issuing a final bill. | 13 | 0 | 200 | 19 | 0 | 450 | 81 | 0 | 435 | 51 | 0 | 45 | 7 |
| Costs of ensuring that a switch is completed within 21 days from the date the consumer enters into contract with gaining supplier, or from date an erroneous switch is agreed, rather than within 21 days of the 'relevant date'. | 11 | 0 | 252 | 39 | 0 | 1,000 | 112 | 0 | 168 | 47 | 0 | 150 | 13 |
| Cost to your organisation of establishing, or extending a mechanism for providing compensation or redress to consumers for the Guaranteed Standards as outlined above | 16 | 0 | 415 | 75 | 0 | 600 | 182 | 2 | 856 | 143 | 0 | 75 | 16 |

| | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Expected cost (fixed and variable per annum) of reporting performance to Ofgem and Citizens Advice. | 9 | 0 | 37 | 14 | 0 | 250 | 56 | 0 | 40 | 12 | 0 | 16 | 4 |
| Expected cost of updating marketing materials and customer facing materials to make customers aware of the new Guaranteed Standards and the supplier's obligations under the new GS mechanism. | 8 | 0 | 98 | 23 | 0 | 2,105 | 342 | 0 | 189 | 28 | 0 | 1,611 | 215 |

# Appendix 2

## Apportionment of cost data to individual Guaranteed Standards

1.1. Table A2 below shows an apportionment of cost to each individual Guaranteed Standard. Where all of a particular cost relates to a particular Guaranteed Standard, we have apportioned that whole cost to that Standard. For other costs, we have distributed them based on the expected incidence of the event which would trigger payment of a Guaranteed Standard. From this analysis, we can see that each individual Guaranteed Standard gives a net positive return based on our static analysis, excluding the fixed costs of applying the Guaranteed Standards as a whole.

**Table A2: Cost apportionment to individual Guaranteed Standards**

| Guaranteed Standards | Estimated occurrence of Guaranteed Standard payments based on 2017 data | Estimated benefits | Percentage share of incidences of Guaranteed Standard payments | Direct cost apportionment | Apportionment of variable People cost (£000) | Apportionment of variable IT/ Systems cost (£000) | Fixed costs | Estimated benefits |
|---|---|---|---|---|---|---|---|---|
| (A) To ensure a switch is completed within 21 calendar days from the date the consumer enters into contract with gaining supplier unless there | 837,000 | 37,665 | 53% | 3,864 | 1,292 | 1,401 | | 31,108 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| are valid reasons for delay to switch | | | | | | | | |
| (A1) To return an erroneously switched customer within 21 working days of identification of an erroneous switch. | | | | | | | | |
| (B) To agree whether a switch is valid or erroneous within 20 working days of identification of the possible erroneous switch. | 44,600 | 2,676 | 3% | | 73 | 79 | | 2,524 |
| (C) To ensure a consumer is not erroneously switched | 89,000 | 4,005 | 6% | | 146 | 159 | | 3,700 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| (D) To send the Erroneous Transfer Customer Charter "20 working day letter" to an erroneously switched consumer. | 19,580 | 587 | 1% | | 24 | 26 | | 537 |
| (E) To issue final bills within six weeks of a switch | 744,000 | 22,320 | 31% | | 756 | 819 | | 20,745 |
| (F) To refund credit balances within ten working days of sending the final bill | 196,900 | 5,907 | 6% | 3,303 | 146 | 159 | | 2,299 |
| Total annual benefit for these measures based on these calculations | 1,931,080 | 73,160 | 100% | 7,167 | 2,438 | 2,643 | 8,655 | 52,257 |

# Appendix 3

## Uplift applied to individual cost categories and benefits assessment

1.2. As part of our information gathering in our RfI, we identified a number of cost areas relevant to assessing the costs and benefits of Guaranteed Standards. A number of suppliers provided cost data and details of the number of incidences of relevant detriment events in 2017, allowing us to estimate 'whole of market' cost and benefits based on the market share of respondents. Table A3 below lists the uplifts that we have applied to the total costs received in the RfI to provide an estimate of whole of market cost. Table A4 shows a similar calculation made for uplift to our assessment of benefits for proposed Guaranteed Standards (B) and (F).

**Table A3: Market share based uplift applied to assessment of costs**

| Cost Category as defined in the RfI | Number of data points received in RfI responses | Total domestic energy market share of respondents to RfI (%) | Uplift applied to cost |
|---|---|---|---|
| Costs of complying with, and monitoring performance of a requirement to refund credit balances within two weeks of issuing a final bill. | 13 | 74.8 | 1.337 |
| Costs of ensuring that a switch is completed within 21 days from the date the consumer enters into contract with gaining supplier, or from date an erroneous switch is agreed, rather than within 21 days of the 'relevant date'. | 11 | 81.8 | 1.222 |
| Cost to your organisation of establishing, or extending a mechanism for providing compensation or redress to consumers for the Guaranteed Standards as outlined above | 16 | 98.4 | 1.016 |
| Expected cost (fixed and variable per annum) of reporting performance to Ofgem and Citizens Advice. | 9 | 72.8 | 1.374 |

| | | | |
|---|---|---|---|
| Expected cost of updating marketing materials and customer facing materials to make customers aware of the new Guaranteed Standards and the supplier's obligations under the new GS mechanism. | 8 | 72.8 | 1.374 |

**Table A4: Market share based uplift applied to assessment of benefits**

| Guaranteed Standard | Number of data points received in RfI responses | Total domestic energy market share of respondents to RfI (%) | Uplift applied to cost |
|---|---|---|---|
| (B) To agree whether a switch is valid or erroneous within 20 working days of identification of the possible erroneous switch. | 8 | 73.8 | 1.355 |
| (F) To refund credit balances within ten working days of sending the final bill. | 8 | 73.8 | 1.355 |