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Dear David,

We are responding to your consultation on strengthening retail financial resilience. This submission is non-confidential and may be published on your website.

Consumers have been hard hit by the significant socialised cost of recent supplier failures, currently totalling £4.6bn. While some supplier failures were likely inevitable with the scale of recent turmoil in wholesale markets, the number and severity of these failures could have been significantly mitigated if there had been better monitoring and compliance of their activities, and stronger rules in place that ensured their financial stability and reduced others' exposure to socialised bad debt.

We strongly agree with Ofgem's analysis that mutualisation of credit balances and the Renewables Obligation incur direct costs to consumers, but also introduces moral hazard that enables risky practices and unsustainable pricing. This increases the risk of supplier failures, with the disruption and wider mutualised costs these entail. These costs can be significantly larger than the value of credit balances and Renewables Obligation payments, as we've seen in recent failures. These issues have already been considered in depth over a number of years, with Ofgem first proposing to tackle them when it launched its supplier licensing review in 2018, and it is very disappointing that reforms were not taken forward in a more timely manner.

Chapter 2: Customer Credit Balances ('CCBs')

While CCBs and Renewable Obligation debts have only accounted for a small proportion of the socialised costs of failures, their significance is larger. This is because their misuse as working capital has enabled unsustainable suppliers to grow - with the knock-on effect of inflating much more significant other socialised costs, like those relating to wholesale costs - when they fail. Figure 2 in your consultation document starkly illustrates the over reliance of failing suppliers on CCBs to fund their businesses.

So we agree with the need for CCBs to be protected by suppliers, both to prevent their socialisation in their own right should suppliers fail, but also to discourage unsustainable growth strategies.

We agree with the proposal that the amount protected should be of Gross Balances net of Unbilled Consumption, noting that a Net Credit Balance approach may not reduce CCB cost mutualisation materially as debit balances will ordinarily be pursued by the administrator and not recoverable by the SoLR.

We can see some reasonable arguments that the calculation of the protected amount should be backward-facing, most notably that this should mean it is neither subject to forecasting error nor require the development and monitoring of forecasting methodologies. But, on balance, we are persuaded by your argument that it should be forward-facing, to take into account the seasonal effect in the build up and reduction of CCBs. Crucially, this would reduce the risk of exposure in Q3 which has historically been when many suppliers have failed.

Because that model will be dependent on forecasting, it will be crucial that these forecasts are credible and that Ofgem undertakes adequate monitoring and compliance to ensure that they are so. As we highlighted in our Market Meltdown report, there have been significant problems with suppliers failing to comply with sector stability measures - perhaps most notably, that only one failed supplier had a 'living will' in place. As it develops its proposals further, we would like to see Ofgem set out more detail on whether it will prescribe the forecasting methodology or leave it to suppliers to determine, and how it will ensure that suppliers will comply with these rules.

Chapter 3: Renewables Obligation ('RO')

We are supportive of the need to try and mitigate the risk of RO socialisation, for the same reasons that it should be mitigated for CCBs.

We agree that your third option, to protect or discharge through ROCs, is preferable to either the first option, which runs the risk of either supplier default or intrusive monitoring, or the second option, which could have a negative impact on suppliers' engagement with the ROC market.

You are proposing that the RO protections are backward-facing, which is inconsistent with the approach you are taking for CCBs, and which you acknowledge would leave four months worth of RO liability at risk of mutualisation. Your arguments for this approach come down to reduced costs to suppliers, that it was their preferred approach, and that it mirrors an approach taken for the FIT levelisation process. In the round, the first of these arguments is the most

theoretically persuasive but we could not see a clear articulation of the cost/benefit trade-off for it in the consultation document. If this remains your preferred approach, we would find it useful if you could more clearly set out the materiality of costs that suppliers might incur compared to the alternative forward-facing approach and the level of benefits that accrue from it.

Chapter 4: Protection mechanisms

We agree that suppliers should be able to select from a menu of protection mechanisms provided these are all consistent with the objectives of making the protected assets insolvency-remote, so that the costs of SoLR are mitigated.

We recognise that some suppliers may be able to access some of the protection mechanisms at a lower cost than others, but consider that insofar as this might be considered a competitive advantage that it is one that is warranted because it reflects their lower risk/higher creditworthiness.

The menu of options you present appears reasonable, although we question whether you need to rule out insurance. You have done so because you argue that it may not be available to suppliers or may be prohibitively expensive. Intuitively, if some suppliers are arguing for it then they must believe that it is neither of those things. If they are able to find insurance, and it is sufficiently insolvency remote, then it may be appropriate to leave that avenue open to them. One would expect that it would only be taken if it was cheaper to that supplier than the alternatives, and those lower costs should flow through to consumer bills.

Chapter 5: Hedging

By far the largest cause of socialised bad debts to date has resulted from wholesale costs, and the ongoing turbulence in wholesale markets suggests that it remains a major risk to consumers. We strongly support your ambitions to try and preserve the value of insolvent suppliers' hedges for the benefit of their customers in order to reduce mutualised costs following the supplier's failure.

We recognise your arguments that relying on waiting for changes to insolvency law may not be prudent. Because insolvency law affects the wider economy, and not simply energy failures, it may be complex and time-consuming to achieve the legislative changes needed to protect insolvent suppliers' hedges via that route.

Based on the information presented, Option 1: Licence change, may be preferable to Option 2: Contractual change. This is partially because the risk of failed debt claims, detailed in paragraph 5.23, may be high if these rules are introduced at a time when the failing supplier is financially fragile, and that appears to be the case

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with many suppliers at present. You also suggest that Option 2 may not fully offset SoLR levy costs but imply that Option 1 would.

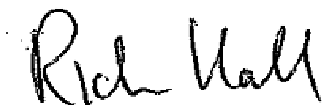
While either licence change or contractual change may be an easier route to follow than seeking legislative change, they are not either/or options and we encourage you to continue to push for any necessary legislative changes that would protect consumer interests in parallel with your development of fallback options should that prove unsuccessful, or slow.

Chapter 6: Capital adequacy

There is considerable interaction between the possible need for capital adequacy requirements and the success (or not) of the other protection measures you are consulting on in this framework. In principle, if those measures are fully successful in their aims, preventing the costs of CCBs, the RO and wholesale hedges from being socialised when suppliers fail, then the argument for separate capital requirements is much weaker. While consumers could still experience detriment from supplier failures through the disruption caused by change of supplier, and potentially from higher prices if the failed supplier was inadequately or badly hedged (nothwithstanding that whatever hedge was in place was protected), it would be significantly reduced.

Given consumers would ultimately pay for any further financial buffers put in place, it will be important that you demonstrate the value added from those buffers if/as you develop these proposals further.

Yours sincerely



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