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Warm Home Discount: Better targeted support from 2022

StepChange consultation response

Introduction

StepChange Debt Charity is the largest specialist debt advice charity operating across the UK. In 2020, over 500,000 people contacted us for advice and information on problem debt.

Last year, among those with responsibility for the bill, over a quarter of our clients (26%) were behind on their electricity bill and 23% were behind on gas, up from 17% and 13% respectively in 2019. This rise is linked to the proportional increase in clients accessing advice through our telephony channel, who have historically been more likely to be in arrears on household bills. However, our research has shown the income shocks experienced by some households during the pandemic along with the cost pressures associated with using increased energy in the home have exacerbated affordability issues in the energy market.[1]

We welcome the Government's proposals to introduce opt-in switching prompts and test opt-out switching to address the loyalty penalty in the energy market. Low-income households are hit by the loyalty penalty more frequently than high income households despite being least able to afford the premium of default tariffs. Research has shown that households on low incomes struggle to find the time to engage in markets.[2] We therefore welcome efforts to prompt consumers to switch. We also welcome the proposed design of the opt-in scheme which testing suggests significantly increases the rate of switching. Given the current surge in wholesale gas prices that is putting many small suppliers at risk, it will be important that any future scheme has the necessary safeguards to ensure minimum service levels between suppliers who are included in the scheme. Although the timelines for opt-out switching are already lengthy, the current market turbulence suggests that several issues need to be worked out to ensure this scheme to encourage switching does not cause undue harm to vulnerable consumers.

Potential barriers to switching remain for those with debt or arrears. We propose adjustments to the Debt Assignment Protocol to ensure that those in debt can utilise switching to help tackle the challenges they face affording ongoing usage while they deal with debt repayments. We also raise the need for information on how suppliers deal with debt to be readily available for those being sent prompts. We continue to raise the use of High Court Enforcement Officers (HCEOs) by energy companies as an excessive method of collecting debts particularly given the recently published guidance suggesting that HCEOs have been wrongly charging VAT to debtors for several years.[3]

[1] StepChange (2020), Tackling the coronavirus personal debt crisis
[2] Eldar Shafir and Sendhil Mullainathan (2013), Scarcity: Why having too little means so much
[3] High Court Enforcement Officers Association (2021), HCEOA issues members with updated recommendation re: VAT on High Court enforcement fees

Testing opt-out switching

1. Are there any other measures you think the Government should consider to help address the factors that have caused a loyalty penalty?

The harm caused by the loyalty penalty is the premium paid by consumers who could be on cheaper tariffs. Households on the lowest income spend a far bigger proportion of their income on household essentials than those on higher incomes which means the harm caused by the loyalty penalty is most acute for these households. The loyalty penalty is also most prevalent among these households. Ofgem has noted that vulnerable consumers are most likely to face the loyalty penalty. 41% of those in the lowest social grade have never switched energy supplier compared to just 21% of those in the highest grade. Evidence has shown that households on low incomes and in poverty are more likely to suffer from a scarcity mindset because a lack of money means that they must spend a lot more time thinking about how to get by rather than other considerations.[4] These households will always struggle to engage with the energy market as active consumers.

Accepting this fact, the government would be better to directly address the harm to these households rather than trying to tackle the factors hindering their engagement with the market. Interventions like the price cap have helped to limit the impact of the loyalty penalty for these consumers but they are still the most impacted demographic. A better safeguard would be a social tariff for these households. This could be like the one proposed by the Consumer Council for Water (CCW) for the water sector where no one would pay more than 5% of their disposable income on water.[5] This type of intervention would eradicate the harm caused by the loyalty penalty.

2. Do you agree with the proposed scope of tariff targeting?

Yes, there will be many consumers likely to be hit by the loyalty penalty who are on tariffs they have chosen but can be renewed indefinitely without expressed consumer agreement. Given that the prompt is just a letter, consumers who are actively loyal to their existing supplier will choose not to switch.

3. Which consumers do you think are more likely to be disengaged with the retail market, for instance due to their circumstances or duration on a default tariff?

Households on low incomes and in poverty suffer from a scarcity mindset. This means that the effort and mental capacity they require just to get by day-to-day limit their ability to make considerations

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[4] Eldar Shafir and Sendhil Mullainathan (2013), Scarcity: Why having too little means so much
[5] CCW (2021), Independent review of water affordability

outside this – engaging effectively in the energy market for example. Targeting low-income households or those in fuel poverty would be an effective way to ensure the scheme reaches those who have become disengaged from the market.

4. Do you think that an opt-in switching scheme should focus on, or prioritise, targeting consumers who have been on a default tariff for longer durations? Please specify if you think any particular duration is appropriate.

We agree that consumers on tariffs for long durations should be targeted but think there is potential in the current context for consumers on fixed term deals and those with their supplier for a shorter duration to possibly benefit from switching. Those who chose tariffs in the last 12 months that roll on indefinitely are at risk of a substantial loyalty penalty given the cost pressures that have emerged. It would make sense to include them in an opt in scheme as they may not realise the extent to which their bill may increase. This includes those on fixed term tariffs. Those on standard variable tariffs are at least protected by the price cap while those on fixed tariffs can be paying £00s more than the price cap leaving them vulnerable to significant unnecessary costs. Given the recent surge in wholesale gas prices these customers will be facing further increases in their costs.

5. Do you agree that an opt-in switching scheme should not target consumers based on the price they pay for their existing default tariff?

Yes. The price someone is paying for a tariff does not indicate the harm caused by the loyalty penalty as those paying a larger proportion of their disposable income on energy may face greater detriment by being stuck on a default tariff. The scheme should adopt the ‘worst first’ principle and target those on lower incomes on default tariffs for whom paying over the odds for their energy carries the greatest risk of harm.

6. Do you agree that an opt-in switching scheme could be effective at creating new competition and market engagement in the PPM tariff market? Are there any PPM market considerations we should take into consideration?

Yes –the high level of standing charges and default tariffs combined with the low level of switching in the PPM market suggests that more switching could lead to more competition and engagement. It will be important to give consumers information on the conduct of suppliers in relation to emergency credit and discretionary top-ups. This support can be vital for PPM customers at risk of self-disconnection.

Currently the Debt Assignment Protocol (DAP) allows for PPM customers with £500 of debt or less to switch supplier. New suppliers buy 90% of the debt from the old supplier and then seek repayment through the meter according to Ofgem regulations on debt repayment. To ensure that PPM customers with debt can switch we believe this threshold should be increased. Last year the average electricity and gas arrears for StepChange clients who were behind on these bills was £1002 and £703 respectively. Both had increased compared to the previous year, illustrating the impact of the pandemic on the depth of arrears faced by consumers in debt. For new suppliers, collecting debt through the PPM is a relatively simple way to retrieve money owed. These consumers are among those who would most benefit from switching to cheaper tariffs and the increased competition on price in this area of the market which may been engendered by opt-In switching. We therefore believe there is a strong case to increase the DAP threshold to £750 or even £1000 per fuel (at least within in the switching scheme) to ensure that all PPM consumers can utilise the scheme.

7. How do you think we should approach batch sizes and frequency? Do you agree with our proposed incremental, test and learn, approach to introduction?

We agree with the test and learn approach. The size and frequency approach seems logical although we are not able to comment on how feasible this is for suppliers with current switching infrastructure. We hope that debt will not be a barrier for consumers accessing the opt-in switching scheme. We propose some ways in which the scheme could be designed to evade some of the barriers that currently exist – the Debt Assignment Protocol thresholds and debt objections in particular – in response to a later question. For these proposals to be implemented successfully batches should not contain too high a proportion of indebted consumers as there will be a risk of lumbering new suppliers with a debt burden they are unable to manage. Ensuring that batches are packaged to include a cross-section of the market would help suppliers predict costs, further enhancing the benefits of the reduced acquisition costs associated with large scale switching. This predictability and the reduced costs will help create space for loosening restrictions on switching for indebted consumers.

14. Please provide views on the consumer protections we are considering. Are there other protections that we should consider?

The current price crisis increases affordability issues for consumers and risks for suppliers. While the Supplier of Last Resort (SOLR) process works relatively well, some consumers face additional risks when suppliers fail. As it stands Warm Home Discount (WHD) costs are not included in those that can be recovered by a new supplier when taking on customers from a failed company. This means that those that have applied or even already been promised the WHD by their old supplier must apply again and may not receive the discount when they transfer.

Prepayment meter customers can face difficulties topping up their meters during the transfer process and sometimes these issues persist once the new supplier has taken them on. For those in debt to small suppliers who fail, administrators that assume responsibility for the debt are not bound by Ofgem's debt repayment framework leaving them at risk of more aggressive collection.

In the context of volatile wholesale prices where risks of supplier failure are increased, these damaging impacts for consumers with suppliers that go under must be considered carefully when designing an opt-in switching scheme. Some of the risks of supplier failure are generated up-stream in the monitoring and authorisation of companies and others are inevitable factors of a market in which suppliers must offer prices based on predictions of future prices. However, risks for consumers can be reduced by tightening consumer protections in the SOLR process and by assessing companies before admission into the opt-in scheme.

It's essential that all suppliers included can maintain the same service levels so that consumers do not find themselves stuck with a supplier with poor customer service, teetering on the brink of failure. The timelines for implementing the scheme mean the picture will likely be different when it starts. However, it may be necessary for the scheme to initially be focussed on switching consumers to cheaper tariffs at their current supplier during periods of market turbulence when large scale switching could introduce more consumer risk than can be justified.

One customer group for whom these considerations are particularly important are those more at risk of debt and arrears than others. For these consumers, the debt collection approach of any new supplier will be an important consideration for them. We have raised the issue of energy suppliers using High Court Enforcement Officers (HCEOs), a costly and traumatic approach to collecting debts. Some suppliers will use this method of debt collection more frequently than others. This should be considered as part of the assessment of suppliers bidding for tariffs or at least information should be provided in switching communications to inform consumers about different approaches.

Opt out switching

27. Do you agree that tariffs should not be compared on variables other than price for testing, but there should be some minimum standards for non-price variables such as customer service? If yes, which variables should be included and how should they be measured/what should be the minimum standard?

Yes, there should be minimum standards for non-price variables. Citizens Advice's consumer star rating analyses suppliers according to five measures – complaints, billing, customer service, switching, customer guarantees. All the suppliers that had failed up to January 2018 were rated below average on this rating, demonstrating how non-price variables are instructive for the sustainability of suppliers.[6] Across these metrics minimum standards could include:

- Minimum percentage of customers getting an accurate bill once a year
- Average call waiting time of 5 minutes or less
- Maximum number of complaints to the Energy Ombudsman per 100,000 customers
- We would like to see the use of High Court Enforcement Officers drastically reduced.[7] Preventing suppliers from accessing the switching regime if they use HCEOs too frequently would be one way to begin to reduce their use

Consumer protection

34. Do you agree with the highlighted potential consumer risks that the scheme will need to consider? Do you think there are risks that we may have missed or other things to consider? Do you agree with our proposed approach to these risks? Are there other protections we should consider?

We agree with the highlighted potential consumer risks. Vulnerable consumers is a very broad category and while the consultation references those on the PSR and others in tenancies where they have less autonomy of over choice of tariff, there will be a diverse range of challenges faced by those in vulnerable circumstances. We welcome the use of qualitative research to better understand these barriers and the exclusion of these groups from initial testing of opt-out switching. Given the current market turbulence and the range of challenges posed by opt-out switching for vulnerable consumers and those with non-standard arrangements, we support a cautious approach to rolling out this scheme.

Debt as a barrier to switching

45. How could the barriers to switching be reduced for indebted consumers?

Some consumers are unable to switch because of debt. Tweaking the Debt Assignment Protocol (DAP) would help pull some of those stuck paying the loyalty penalty onto cheaper tariffs. Our research has found that over 1.5m people are behind on their electricity bill and over 1m are behind

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[6] Citizens Advice (2018), Picking up the Pieces A review of the consumer impact of recent energy supplier failures
[7] From discussions with High Court Enforcement Officers, we believe that on a conservative estimate around 25,000 high court writs were issued in pursuit of energy debts last year.

on their gas bill.[8] Last year the average arrears faced by StepChange clients behind on these bills was £1,002 and £703 respectively.[9] Under current regulations suppliers can block consumers switching if they've been in debt for more than 28 days in the case of a credit meter or if they owe more than £500 on a prepayment meter. Indebted consumers using credit meters who wish to switch must settle their debt as part of their final bill. For those on prepayment meters the debt transfers to their new supplier and they must agree a reasonable repayment plan under Ofgem's repayment framework. Those under these thresholds can use the DAP to switch to a cheaper tariff. In many cases the consumers unable to switch will be stuck on expensive default tariffs, Ofgem's own research has demonstrated that those paying the loyalty penalty are concentrated among lower income households who are also more likely to be behind on bills. Being able to switch onto a cheaper tariff is an essential way to tackle the affordability challenges faced by these individuals.

Altering the DAP thresholds for the purposes of the switching scheme would allow more consumers to access the benefits of switching. We propose increasing the £500 limit to £750 or £1000 for PPM debt and the 28-day limit replaced with a debt limit, perhaps like the PPM limit, for credit meter debt. Given the average debt faced by our clients far exceeds £500 the current limit appears restrictive. It is also notable that debt levels have increased over the course of the pandemic. This makes switching indebted customers who are trapped on expensive tariffs even more urgent.

Ofgem's review of debt objections in 2016 suggested that extending DAP could leave certain suppliers over exposed to debt, reduce new entrants and lead to more aggressive debt management practices from suppliers (including the need for security deposits or PPM installation).[10] While these fears are not unfounded, we feel the opt-in scheme offers a way to trial changes to DAP in a secure fashion. Suppliers involved in the scheme are likely to benefit from significantly reduced acquisition costs under the plans for collective switching of 100,000s of consumers. If the profile of these batches was carefully designed to ensure that indebted consumers were not overly concentrated, the client acquisition savings help offset any impact form extending the DAP thresholds without placing undue risk on suppliers. These changes could be tested through the opt-in scheme rather than implemented market-wide to assess their impact. In the case of PPM debt this can be safely collected through the meter according to Ofgem's repayment principles. It will be important that safeguards are placed on supplier approaches to indebted credit meter consumers. Security deposits and forced PPM installation should be avoided while debt recovery should not involve rapid escalation. As previously stated, we would like to see greater restrictions on the use of High Court enforcement by energy suppliers generally.

Ofgem's 2016 review also led to new provisions for debt objection letters after it was found that very few consumers who were subject to a debt objection switched to a cheaper tariff at their current supplier. At the suppliers analysed as part of this review only 5% of consumers prevented from switching due to debt moved to a cheaper tariff at their existing supplier.[11] Given savings can often

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[8] StepChange (2021), Stormy Weather
[9] StepChange (2021), Statistics Yearbook 2020
[10] Ofgem (2016), Review of domestic debt objections
[11] Ofgem (2016), Review of domestic debt objections: Our decision

be almost as drastic between tariffs at the same supplier, improving internal switching could be just as beneficial as switching between suppliers for those in debt. As part of the conditions of involvement the switching schemes could place more coercion on firms to switch consumers to cheaper tariffs where they had indicated a desire to switch to a new supplier but were blocked because of a debt objection. This would mitigate some of the harm caused to indebted consumers by the DAP conditions which, even if extended, would still prevent many indebted consumers switching. Letters should also include signposting to debt advice agencies so that those looking for more support with their debts are aware of the help available.

46. How could opt-in switching and opt-out testing be designed to effectively support indebted consumers?

People in debt often ignore official communications as they fear demands for repayment that they can't afford. It will be important, therefore, to ensure that communications related to switching use channels in line with consumer preferences and do not appear too intimidating for indebted consumers to engage. If possible, communications should acknowledge an individual's debt problem so that consumers can be reassured that their debt does not necessarily prevent them from switching to a cheaper tariff. In cases where consumers may be disqualified from switching because of the Debt Assignment Protocol or the conditions of the new supplier, consumers should be signposted to cheaper tariffs at their current supplier.

Reducing the cost of ongoing usage is essential for helping people deal with problem debt, building up savings and the financial resilience needed to withstand income shocks. 40% of respondents to our *debt advice outcomes* surveys highlighted 'switching to cheaper deals', included fuel tariffs as being important in helping them become debt free. Conversely, clients with negative budgets (essential expenditure, including fuel bills, higher than income) were much more likely to still be struggling with fuel bills even 15 months after advice.[12] Shifting these consumers onto cheaper tariffs should be the priority, whether at their current supplier or a new one. Signposting to debt advice is a vital to encouraging people to tackle their debt problems. Indebted individuals receiving op-out communications would benefit from clear signposting at this stage. Involving debt advice providers in the design and testing of the scheme would also help ensure it meets the needs of indebted consumers.

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[12] StepChange (2020), Paths to recovery: Understanding client outcomes 15 months after debt advice