National Energy Action (NEA) briefing on Ofgem's Debt and Affordability Call for Input

Introduction

National Energy Action (NEA), the fuel poverty charity, campaigns so everyone can afford to live in a warm, safe and healthy home. This is something denied to millions because of poor housing, low incomes, and high bills. National Energy Action and many other organisations have been highlighting the problems of affordability and record levels of debt in the market, for a long time. Ofgem has opened a Call for Input on the subject, which will close on 13 May 2024. This briefing highlights National Energy Action's emerging views on what Ofgem and government can do to tackle affordability and still-rising debt levels.

Background

In April 2024, the energy price cap will fall to £1,690 for the typical dual fuel household that pays by direct debit. Ofgem recently decided to change the level of consumption that it uses to calculate what a 'typical' household might pay. Under the previous calculation, the price cap would be announced as £1,769. This is 56% higher than the price cap prior to the beginning of the energy crisis, which was £1,138 for the typical dual fuel household that pays by direct debit. We estimate that the new price cap level leaves about 6 million UK households in fuel poverty, based on a definition of spending 10% or more of income on energy costs.

Alongside the price cap announcement, Ofgem confirmed that debt levels are continuing to rise and now sit at around £3.1bn. In the Call for Input document, Ofgem confirms that the average level of debt has increased by around 50% in the past 12 months. The number of households in debt has increased by around 20%. This indicates that not only are more households falling into debt, but for those already in debt the affordability pressures are much greater. Furthermore, about two-thirds of the overall debt figure consists of arrears. This is defined as debt without a repayment arrangement. The remaining third consists of debt where a repayment arrangement is in place. This further highlights the challenge of debt: that it will continue to grow.

How did we get here?

There are several reasons for why debt levels and affordability pressures have increased over the past few years – it isn't just because of high energy prices.

Standing charges have almost doubled over the past five years, with households now paying over £300 a year, regardless of payment method. This covers fixed costs associated with maintaining and expanding energy networks, paying for environmental and social schemes, as well as providing energy suppliers with income to service the rise in energy debt in order to keep them afloat.

Additionally, scheme delivery failures in the case of the Warm Home Discount and Energy Bill Support Scheme means that around £200 million of energy bills support has not reached households.

There are also problems with how the price cap is structured. At the moment, between 80% and 90% of households are on a Standard Variable Tariff (SVT), which must be compliant with the price cap levels set by Ofgem. Decisions about how to allocate costs, particularly debt-related costs, to households have predominantly resulted in higher prices for lower-income households. Recent policy changes have made prepayment the cheapest payment method, which will provide much needed relief for the high proportion of prepayment households that are fuel poor. Standard credit users remain at a disadvantage, paying significantly more than direct debit or prepayment households. Ofgem is considering a reform to reduce this payment premium, but until it is introduced, households who pay by standard credit will continue to face unfairly higher bills.

Finally, there are problems with how the price cap factors in costs that suppliers face regarding debt. As debt levels have risen drastically in a short period of time, Ofgem has had to fulfil its responsibility under the price cap to allow energy suppliers sufficient allowances within the cap to recover reasonable costs. Based on price cap allowances as of April 2024, suppliers collect a total of between £1bn and £1.5bn per year to mitigate the impact of rising debt levels, pushing up household bills further.

Market wide debt and affordability mechanisms

National Energy Action have been advocating for an enduring mechanism to provide affordable energy bills to struggling consumers for a long time. National Energy Action's preferred mechanism would be the introduction of a social tariff.

Because of record levels of debt in the market, National Energy Action also believes that there is a need for policy support to help consumers pay off their debt. National Energy Action's preferred approach for this would be the introduction of a 'help to repay' scheme, in which the government would match contributions from households.

This consultation demonstrates the extremity of the situation with regards to ongoing affordability pressures and still-rising debt levels in the market. It would be remiss not to mention that these forms of policy intervention are needed just as much now as they were in the peak of the energy crisis.

Whilst this consultation focuses on what Ofgem can do, National Energy Action feels it is important that the input provided by stakeholders is shared with government to ensure government is able to continuously assess the need for intervention. In the consultation document, Ofgem has highlighted that it may be prepared to make recommendations to government based on the responses received. National Energy Action feels this is an important opportunity for Ofgem to publish additional evidence which further highlights the severity of affordability pressures and the deepening challenge of recovering debt.

What are the problems and solutions?

Problem	Brief explanation	Possible solution
High prices mean that debt and affordability are more than just regulatory issues – they're policy issues too.	Prices are 49% higher than they were prior to the beginning of the energy crisis. National Energy Action estimates there are 6 million fuel poor households in the UK, as of April 2024. Many households have a negative budget, meaning that they fall further into debt every month in order to pay for essential products and services. A 'help to repay' scheme would help to significantly reduce the burden of debt on many households, which would have benefits for energy suppliers' financial resilience, the mental and physical wellbeing of indebted households, and for all households more generally in the form of reduced bills.	Government should introduce deeper and broader price support for low-income and vulnerable households. Government should also bring forward a 'help to repay' scheme.
Ofgem policy currently focuses on servicing debt, not reducing it.	Suppliers collect between £1bn and £1.5bn through price cap allowances to service debt. The majority of this funding goes towards servicing debt. It is unclear how much of this is directly allocated to reducing debt costs.	Mandate the use of (some of the) debt allowances to write off debt.
The structure of the price cap facilitates the creation of additional debt	Households that pay when they receive a bill (standard credit) are most likely to be in debt, when compared to direct debit households. Though they face higher costs, the bulk of the debt-related costs that suppliers collect to service debt is allocated to them.	Reduce the standard credit premium by redistributing debt-related costs with direct debit households.
Early identification of financially vulnerable customers is poor	Early engagement with those who are falling behind on bills can prevent problem debt. Without the means to identify these customers, suppliers cannot properly protect them.	Introduce a flag for financial vulnerability in the Priority Services Register.
Prepayment meters offer a blunt solution to problem debt, with inadequate consumer outcomes.	Especially in the case of traditional prepayment, there is a barrier of disengagement between households and energy suppliers. Suppliers are unable to know when a household is frequently self-disconnecting, or whether it is happening for long durations. Equally, households are less likely to contact their energy supplier to ask for support.	Accelerate the smart meter rollout. This should prioritise the replacement of traditional prepayment systems.
High standing charges facilitate build-up of debt during self-disconnections.	For prepayment households, standing charges accrue on the meter even while the supply might be disconnected. This means that households can accrue debt for as long as they cannot afford to top up.	Reduce standing charges for prepayment customers. This carries considerably less risk than reducing standing charges for all customers, since prepayment is not a suitable payment method for high-usage, financially vulnerable households.