
Wholesale Retail Code Change Proposal – CPW060

Modification proposal	Wholesale Retail Code Change Proposal – CPW060 – Clarifying credit scores and ratings for the purposes of Unsecured Credit Allowances
Decision	The Authority has decided to approve this Change Proposal
Publication date	13 September 2019
Implementation date	30 September 2019

Background

Ofwat commissioned a review of credit arrangements in the Non-Household retail market from KPMG. The [KPMG review of credit arrangements for the non-household retail market](#) (“**the KPMG Report**”), published in June 2018, made a number of recommendations, including increasing the clarity, consistency and effectiveness of allocating Unsecured Credit Allowances based on credit assessment scores. Amongst other recommendations, it recommended that a Change Proposal could be developed to make clear that:

1. Credit reports should be provided by Retailers more regularly than once every 12 months, for example every quarter;
2. Wholesalers must accept the findings of that credit report where it has been obtained from one of the listed credit reference agencies;
3. Unless there is a significant change affecting a Retailer’s financial standing, credit reports will not need to be updated more than every quarter; and
4. Where Wholesalers wish to directly obtain a Retailer’s credit report, it must inform the Retailer before doing so and ensure that obtaining the report will not have a negative impact on the Retailer’s credit score.

The issue

This Change Proposal was developed by a working group of the Panel (the Credit Committee) in response to the recommendations in the KPMG report.

Regarding the frequency of provision of credit scores/ratings, the Wholesale Retail Code (WRC) currently requires that a Retailer must submit evidence of its credit score or rating to the relevant Wholesaler every 12 Months. Where the Retailer holds

two or more ratings, it is also a requirement that the lowest of these ratings is provided. The KPMG report suggested that provision of a credit score/rating every 12 Months means that there are long periods during which credit scores or ratings could have significantly changed. It also highlighted that there may be a lack of clarity about the roles and responsibilities of trading parties in monitoring and reporting credit scores.

Regarding the recommendation that Wholesalers should accept the findings of a credit report, the KPMG report suggested that the current position in the WRC may result in ambiguity around the role of Wholesalers in challenging or accepting the scores provided by Retailers. It has also been suggested that the requirement for the lowest score/rating to be provided creates difficulties for Wholesalers in establishing that they have been provided with the lowest available score or rating. In some cases, Retailers are reportedly not providing the lowest available score or rating. The Panel's Final Report suggests that this may be because of interpretation of the requirement, in that if a Retailer only obtains one credit score or rating, it will provide this as it will be the lowest that it is aware of.

The WRC also places an obligation on Retailers to inform the relevant Wholesaler(s) where there has been a material change in circumstances that affect the credit score or rating, within three Business Days of being informed by the credit reference agency. However, the Final Report provided by the Panel indicates Wholesaler members of the Credit Committee have highlighted that in practice, this is not happening. The Final Report also suggests that the WRC is not explicit in the consequences of a Retailer failing to adhere to its obligation in this regard.

In addition to the above, the KPMG report highlighted that some Retailers were concerned that when Wholesalers request credit scores/ratings that this can have a negative impact on their credit scores/ratings. The Credit Committee has written confirmation from credit reference agencies¹ that this is not the case (although one credit reference agency added an 'in certain circumstances' caveat). Therefore, as the Credit Committee is satisfied that it is unlikely that there would be negative impacts from Wholesaler requests for credit scores/ratings, no amendment to the code was proposed.

¹ The Credit Committee liaised with the following credit reference agencies: Experian, Dunn & Bradstreet and Equifax.

The modification proposal²

The Credit Committee primarily focused on recommendations one and two above when developing this proposal.

The following modifications have been proposed:

- Retain the requirement for a credit score/rating to be provided every 12 Months, but enable Retailers to select their preferred credit score or rating, as opposed to being required to provide the lowest;
- To prevent frequent changes to credit scores/ratings as a consequence of the above, a Retailer must provide a Wholesaler with three Months' notice in advance of any such change in credit reference agency;
- Amendment to the requirement that a Retailer must confirm its credit score or rating every Month. The requirement to provide additional credit scores/ratings is proposed instead to be at the reasonable request of the relevant Wholesaler, and not more than once every three Months;
- To add clarity around the consequences for a Retailer failing to notify a Wholesaler of a material change in its credit score or rating within five Business Days of being informed by the credit reference agency. It is proposed that Wholesalers, where they have not been notified of a downgrade in credit score/rating and they have evidence of such downgrade, would be able to apply amended credit scores. This would result in either a lower or zero Unsecured Credit Allowances being available to the affected Retailer. The Wholesaler would be required to provide five Business Days' notice in advance of applying a decreased credit rating.
- Amendment to Schedule 2E paragraph 8 of the Business Terms to add clarity around the requirement for Retailers to provide evidence of their credit rating or score every 12 Months.

Industry consultation and assessment

The Request for Information on the draft Change Proposal (DCP019) was published on 7 March 2019 and closed on 21 March 2019. There were 21 responses received, 17 from Wholesalers and eight from Retailers.

Agreement with the proposed solution

The majority (20 respondents) agreed with the proposed solution. The main reasons cited were that this change would provide clarity, consistency and transparency to the arrangements whilst also providing an element of flexibility.

² The proposal and accompanying documentation is available on the Market Operator website at <https://www.mosl.co.uk/market-codes/change/changes>

One Retailer respondent, although agreeing that Retailers should be able to select their preferred credit score/rating, did not agree with the proposed solution. It argued that Wholesalers should not be permitted to change credit score/rating to reflect a downgrade in response to not being notified by a Retailer, as the Retailer has not had the opportunity to take corrective actions where the report is erroneous. This Retailer suggested that the proposed consequences for failing to notify the relevant Wholesaler creates a direct cost as Retailers will need to provide additional working capital.

The Retailer that did not agree also said that the notice period required during a change in agency is commercially unrealistic and exposes Retailers to excessive costs and uncertainty. In addition, it highlighted that credit reference agencies and third parties can make errors which might negatively affect a Retailer's credit score/rating. This Retailer suggested that it can take between two weeks and a month to remedy such errors meaning that a three Month notice timeframe to change to an alternative credit reference agency is unreasonable.

One Wholesaler, whilst agreeing with the proposal, suggested that a centralised solution whereby MOSL obtained the credit reports/scores and made them available to Trading Parties would add value.

Red line drafting

19 respondents agreed that the red line drafting reflected the intended solution. Two respondents, one Wholesaler and one Retailer did not agree. The Retailer that did not agree did not comment on the red line drafting as it did not agree with the proposal. The Wholesaler that did not agree considered that whilst these changes were being made, there was opportunity to add additional clarity to provide certainty for Trading Parties. This Wholesaler also stated that it would like the specification of credit scores/reports defined in the market codes.

Retailer choice of credit rating or score

The majority of respondents agreed with the proposal for Retailers to choose their credit score or rating.

One Wholesaler said that it was disappointed that the Change Proposal removes the requirement for the lowest score to be provided, as it considers this to be a transfer of risk to the Wholesaler. Another Wholesaler highlighted that there are different types of credit reports available within the same credit reference agency which can produce different credit scores.

Notification timeframe to change credit reference agency

The majority of respondents agreed and considered that three Months was a reasonable timeframe for Wholesalers to process any necessary changes whilst also limiting frequent changes in credit reference agency. One Wholesaler agreed with this timeframe but suggested that it may be more notice than is required for a Wholesaler to process the change.

One Retailer that did not agree with the proposal overall, did not agree with the proposed timeframe. It stated that Retailers need flexibility to deal with situations where the provider agency changes its methodology without informing the Retailer. It believes it is not appropriate for Retailers to be held to a score/rating if the services are withdrawn or materially changed by the provider agency.

Failure to notify Wholesaler of a downgrade in credit score/rating

19 respondents (13 Wholesalers and 6 Retailers) agreed that Wholesalers may adjust or remove the Unsecured Credit Allowance where Retailers fail to notify Wholesalers that its score or rating has been downgraded.

One Retailer highlighted that it is a responsibility of each Retailer to make the necessary notification but suggested any action following a failure to do so should be at the discretion of the Wholesaler.

A Retailer disagreed with the proposal that the Wholesaler could adjust or remove the Unsecured Credit Allowance where a Retailer fails to notify it of a score or rating downgrade. It argued that increasing the frequency of provision of credit score/ratings by Retailers, rather than retaining the current timeframe of once every 12 months, would mitigate this issue. Another Retailer also disagreed, stating that credit reference agencies could introduce erroneous data which could affect the integrity of the report.

Implementation Date

The majority of respondents agreed with the proposed implementation date. However, one Wholesaler highlighted that this change is not significant and therefore, it did not consider that there is a need for a lengthy lead time before implementation. There was a general consensus from respondents that an earlier implementation date would be preferable.

Objectives and Principles of the WRC

The majority of Trading Parties agreed that this change better facilitates the Objectives and Principles of the WRC against Transparency, Efficiency, and Proportionality.

One Retailer however, thought the Change Proposal was discriminatory as it considers there to be significant cost implications for independent Retailers. It also suggested that the proposal fails to take account of the differential impacts on independent Retailers.

Committee views following the Request for Information

Following the Request for Information, the Credit Committee considered the points raised by respondents.

It is the Credit Committee's view that the three Months' notice period for changing Credit Reference Agency was reasonable. It considers that this timeframe does not preclude the parties from discussing specific circumstances affecting Retailers where a change could be appropriate.

It also considered a suggestion that Wholesalers should be obligated to share settlement information with Credit Reference Agencies, but concluded that this would not require a code change. In considering the requests for flexibility by Wholesalers in determining whether to downgrade a Retailer's Unsecured Credit Allowance, the legal drafting used the word "may", therefore this action is discretionary.

The Credit Committee also made some amendments to the draft Change Proposal in response to some of the comments made by Trading Parties. The changes were as follows:

- Introduction of a requirement that a Retailer must be provided with five Business Days' notice where a Wholesaler intends to amend its credit score or rating after it has obtained evidence of a downgrade of that Retailer's score/rating.
- Extension of the notice periods for both the Retailer and Wholesaler to five Business Days in order to provide time for communication between the parties rather than consider a separate disputes process. This notice period also should provide the opportunity for parties to establish if they are looking at different reports from the same Credit Reference Agency. It took the approach that enabling a Wholesaler to change scores and ratings was a way of resolving the issue of a Retailer failing to notify of a downgrade.

Panel recommendation

The Panel considered this Change Proposal at its meeting on 28 May 2019. It recommended, by a unanimous decision, that the Authority approve this proposal on the basis of improving the principles of efficiency, transparency and proportionality. The recommended date of implementation is 30 September 2019.

Our decision

We have considered the issues raised by the modification proposal and the supporting documentation provided in the Panel's Final Report. We have concluded that the implementation of CPW060 will better facilitate the principles and objectives of the Wholesale Retail Code detailed in Schedule 1 Part 1 Objectives, Principles and Definitions and is consistent with our statutory duties.

Reasons for our decision

Having reviewed the evidence provided by the Panel in its Final Report, we consider that approving this Change Proposal will bring benefits for the market. It is our view that the changes provide clarity around the process for using either a Current Credit Score or Current Credit Rating to obtain an Unsecured Credit Allowance. For example, enabling a Retailer to provide its preferred credit score/rating gives clarity to Trading Parties in respect of the requirements for the provision of this information, particularly as it appears there were previously different interpretations as to what the requirements were.

We have set out below our views on which of the code principles are better facilitated by the Change Proposal.

Transparency

This Change Proposal increases clarity in the WRC regarding the use of Unsecured Credit Allowances. It also provides a consistent approach to use of credit ratings/scores and removes ambiguity that may arise due to different interpretations.

Proportionality

The Change Proposal provides a proportionate solution to the identified issues, particularly given that it incorporates an element of flexibility for both Retailers and Wholesalers.

Decision notice

In accordance with paragraph 6.3.7 of the Market Arrangements Code, Ofwat approves this change proposal.

Georgina Mills

Director, Business Retail Market