Market Performance Framework (MPF) Reform

Update on capping, redistribution and approach for financial tools

6 November 2024

Agenda

	Item	Presenter	Time
1	**Welcome & update**	**Miles Robinson (Chair)**	**10 mins**
2	Update on approach for penalty charge cap	Oli Robins	30 mins
3	Performance-based redistribution proposal	Oli Robins	30 mins
4	General approach for setting charges and standards	Oli Robins	20 mins
5	Upcoming PAG workshops & AOB	Miles Robinson	10 mins
			Total: 1 hour 40 mins

To cover

- Update on current thinking for capping penalty charges
- Proposal for performance-based redistribution
- Proposed approach for setting charges and standards.

Seeking PAG feedback on updates and proposals

Housekeeping

Welcome all – please introduce yourself in the chat

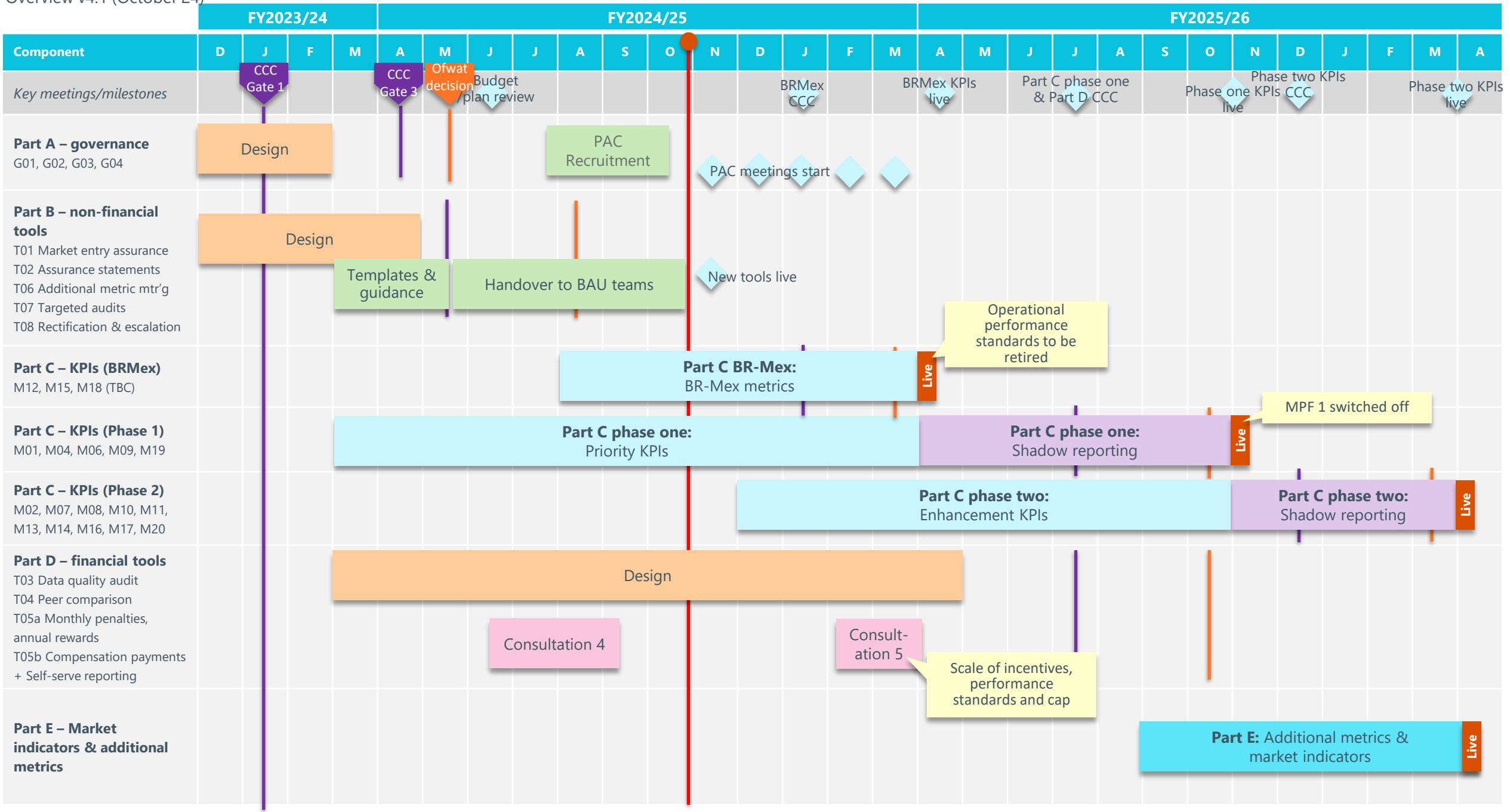
Workshop format – input and feedback needed

We will allow time for discussion and questions
Questions via mpfreform@mosl.co.uk

MOSL Website for Agenda, Minutes & Slides

Revised programme plan

Overview v4.1 (October 24)

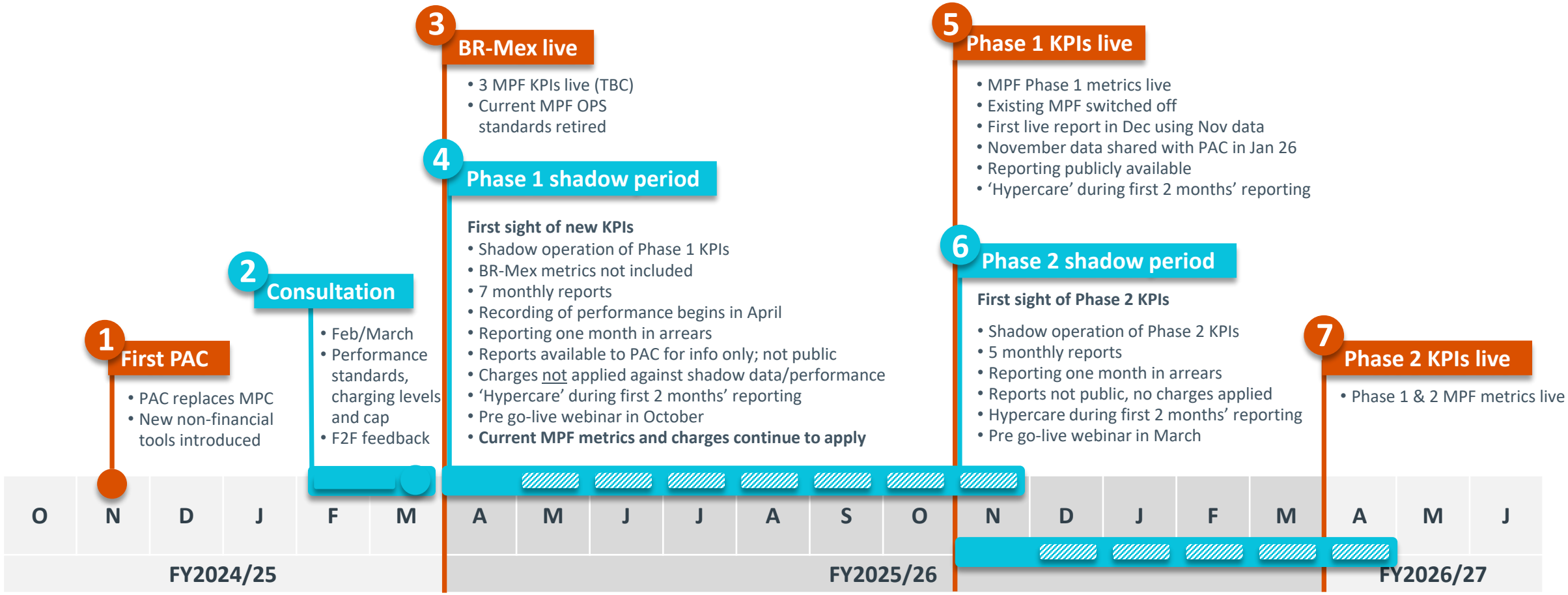


MPF Reform

Progress overview - updated

Part	Deliverables	MOSL	PAG	CAG	Doc Issued	Web-inar	Pre-CCC	CCC	Build	Test	Ofwat	Implement
Part A	Governance	✓	✓	✓	✓	✓	✓	✓	N/A	N/A	✓	Nov
Part B	Non-financial tools	✓	✓	✓	✓	✓	✓	✓	✓	N/A	✓	Nov
Part C	**BRMex**	✓	✓					Jan 25			Mar 25	April 25
	Phase 1: Priority KPIs	✓	✓					July 25	✓		Oct 25	Nov 25
	Phase 2: Enhancement KPIs							Dec 25			Mar 25	April 26
Part D	Financial tools	✓						July 25			Oct 25	Nov 25
Part E	Market indicators & additional metrics							N/A			N/A	TBC

MPF Delivery Plan
Overview



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Update on approach to penalty charge cap

Reminder

Consultation 4 proposal:

- Remove the concept of a cap completely. No cap in MPF 2.0.

Consultation feedback:

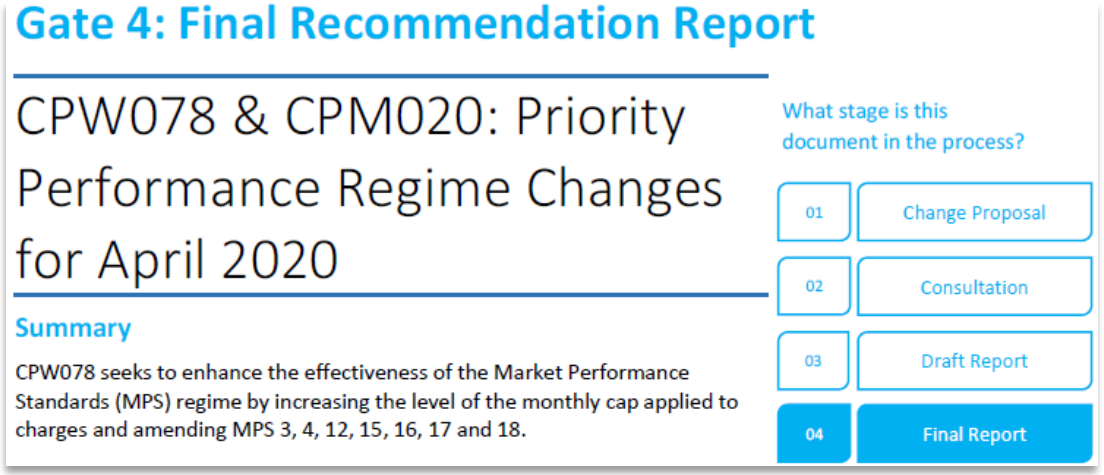
- A cap on penalty charges provides protection and stability - particularly important in early MPF 2.0.
- Absence of a cap leaves the market exposed to extreme scenarios outside party control
- The shadow period can be used to confirm the suitability of a proposed cap
- Other MPF tools can be used to address trading parties that consistently hit a cap

Emerging proposal:

- **MPF 2.0 will include a cap on penalty charges at implementation, pending further discussion with the PAG.**

Context

- MPS charges are currently capped.
- The current cap works by multiplying a trading party's R1 settlement value by 0.25%.
- The lower value between this capped value vs monthly MPS charges is then taken and invoiced.
- The scaling factor used to be 0.15% before **CPM020 & CPW078** was implemented in April 2020. Under 0.15%, ~70% of SPIDs would take capped charges.



Gate 4: Final Recommendation Report

CPW078 & CPM020: Priority Performance Regime Changes for April 2020

Summary

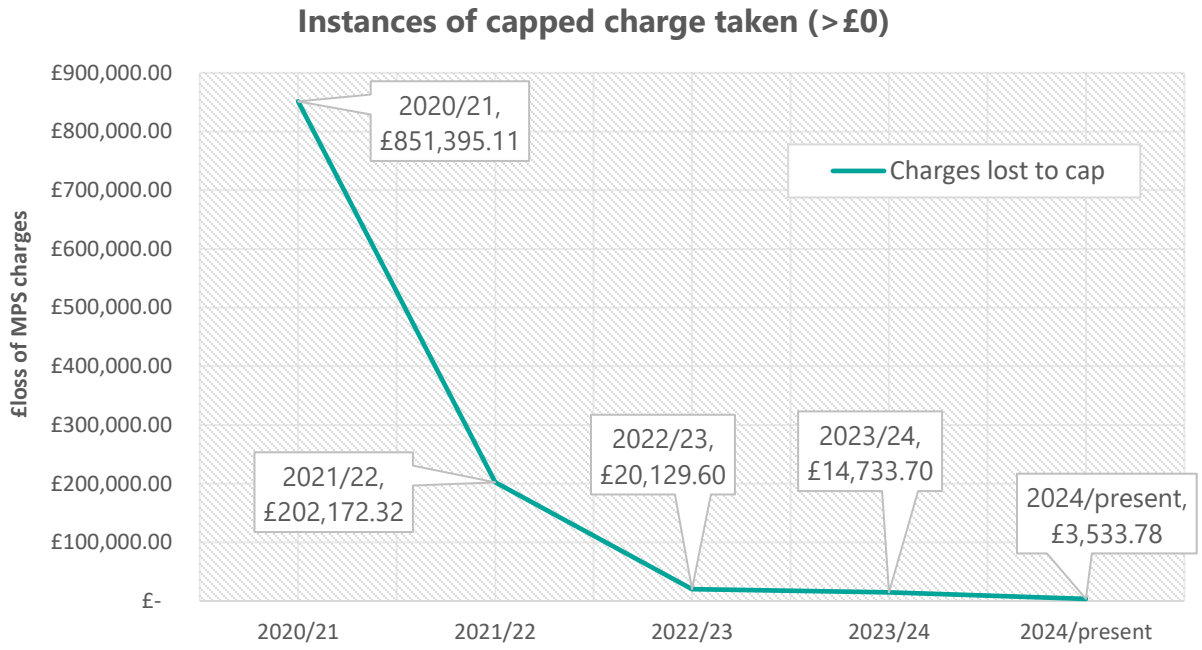
CPW078 seeks to enhance the effectiveness of the Market Performance Standards (MPS) regime by increasing the level of the monthly cap applied to charges and amending MPS 3, 4, 12, 15, 16, 17 and 18.

What stage is this document in the process?

01	Change Proposal
02	Consultation
03	Draft Report
04	Final Report

Context

- The capped value has been taken less frequently in recent years.
- Instances where a capped value has been taken has reduced from ~16% to ~7% of monthly calculations from 2020 to 2024, and in 2023/24, only 3% of monthly calculations took a capped value over £0.
- The total MPS charges "lost" to the cap in 2023/24 equaled ~0.7% of total uncapped charges.
- A small number of TPs are still hitting the cap regularly, but these are small parties with low SPID numbers where the difference between capped and uncapped charges is minimal.



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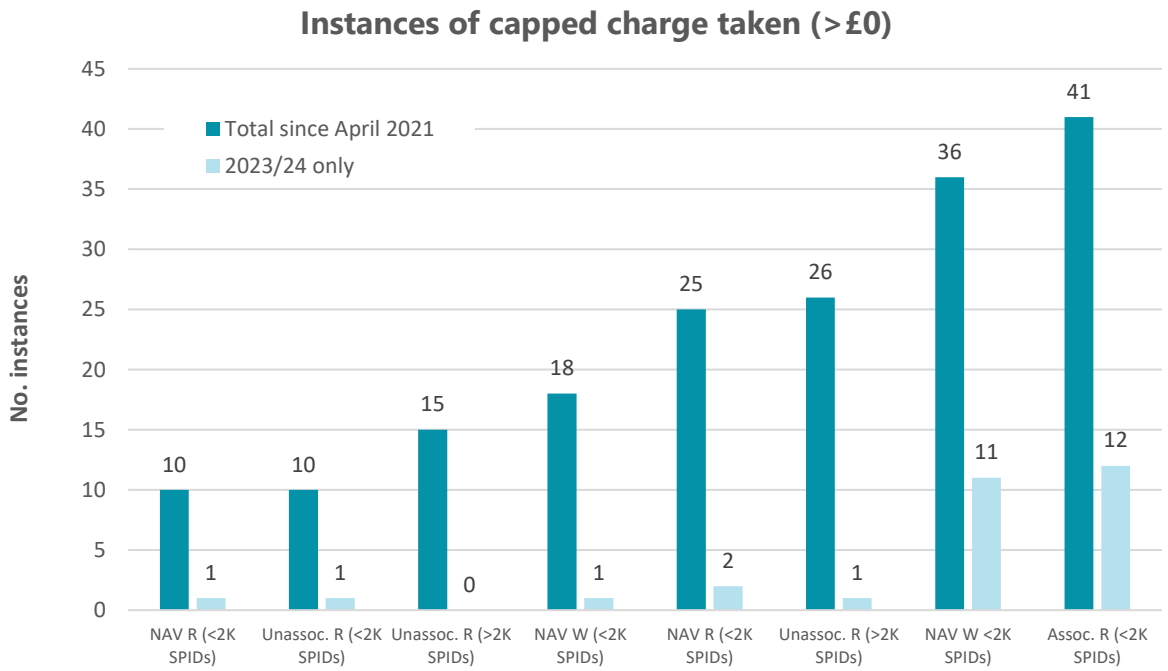

Emerging proposal

Proposal:

- MPF 2.0 will include a cap on penalty charges at implementation
- This is envisaged to be a monthly cap based on R1 that applies across all KPIs and will be set at a level that will not be routinely hit, but offers realistic protection
- A proposed level will be shared with the PAG before consultation five (once charges and standards have been modelled) and the final level will be confirmed before shadow.

Emerging proposal

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Simple – method works and no clear case for change

Minimal code change, process change, and learning required

Clarity pre shadow

Market stability

Emerging proposal

Other options considered

Different caps for each KPI?

- ✓ Potential for bespoke, flexible and targeted approaches
- × Additional complexity

Force majeure caps?

- ✓ Clear expectation for BAU performance with flex to introduce capping in extreme events only
- × Complicated (definitions and processes may be open to interpretation)
- × No obvious precedent.

Cap with end-of-year 'truing up'?

- ✓ A 'safety net' as parties who regularly hit the cap across the year are then required to pay up to a second, annual cap.
- × Overcomplicated

Type and level confirmed after shadow?

- ✓ Level can be determined with fewer unknowns
- × Additional uncertainty and risk of a gap

Based on consumption or SPID count?

- × Not as strong indicators of revenue
- × Do not account for inflation
- × Consumption caps would conflict with targets to reduce consumption

Discussion

Discussion points:

- In principle, should a cap ever be reached in BAU?
- Should the PAC have a role in reviewing and/or flexing the level of the cap?
- Should there be a sunset clause on a proposed cap, e.g., cap only exists for five years?
- What other action should be taken where a party consistently hitting a cap for poor performance?

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Performance-based redistribution proposal

Reminder

Consultation 4 proposal:

- MPF 2.0 will see 'outperformance payments' being issued at years' end for the proportion of performance that exceeds an outstanding performance standard.
- Payments to Retailers would be funded only by Retailer penalty charges – same for Wholesalers.

Consultation feedback:

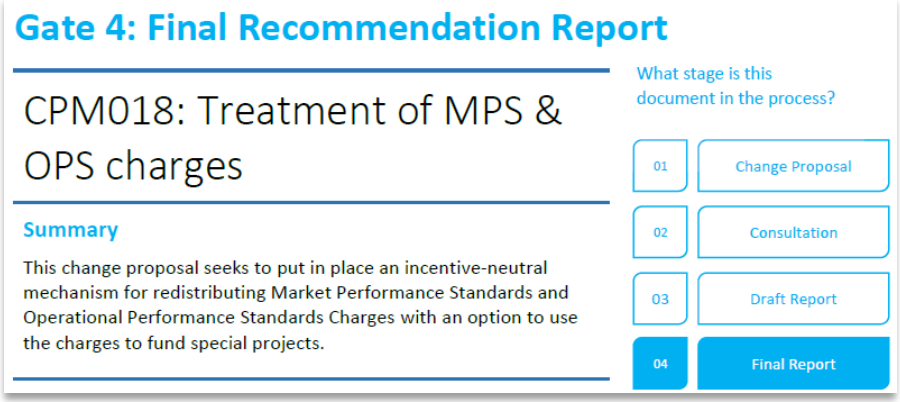
- Code obligations are absolute – cannot 'outperform' a code obligation.
- TPs will strive for 100% performance with or without MPF financial reward.
- Need a better use of penalty charges than 'standard redistribution'.

Emerging proposal:

- **Recontextualize the mechanism of 'outperformance payments' as 'performance-based redistribution', ("PBR") pending further discussion with the PAG.**

Context

- The current method of redistribution was introduced in January 2020 by **CPM018**
- The solution introduced a default "incentive neutral" redistribution with the option to use some/ all charges to fund other activities via more suitable mechanisms (i.e., the Market Improvement Fund (MIF)).
- MPS and OPS charges are returned to parties at year end (minus what is reserved for MIF), although each party only receives a share of the charges paid by other parties, not the charges they directly pay.
- ~70% of charges (~£5.9M) have been returned from April 2021 to March 2024.



Gate 4: Final Recommendation Report

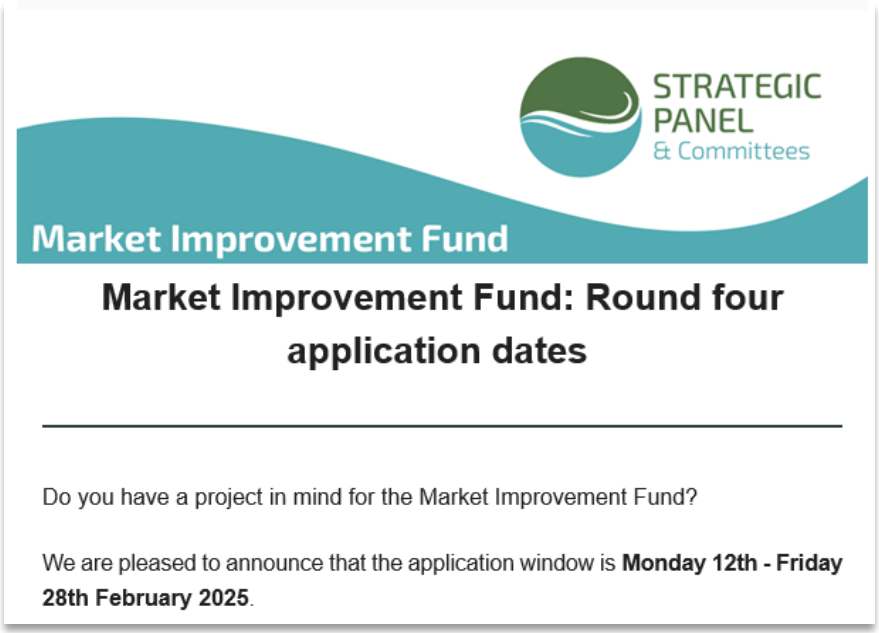
CPM018: Treatment of MPS & OPS charges

Summary

This change proposal seeks to put in place an incentive-neutral mechanism for redistributing Market Performance Standards and Operational Performance Standards Charges with an option to use the charges to fund special projects.

What stage is this document in the process?

01 Change Proposal
02 Consultation
03 Draft Report
04 Final Report



STRATEGIC PANEL & Committees

Market Improvement Fund

Market Improvement Fund: Round four application dates

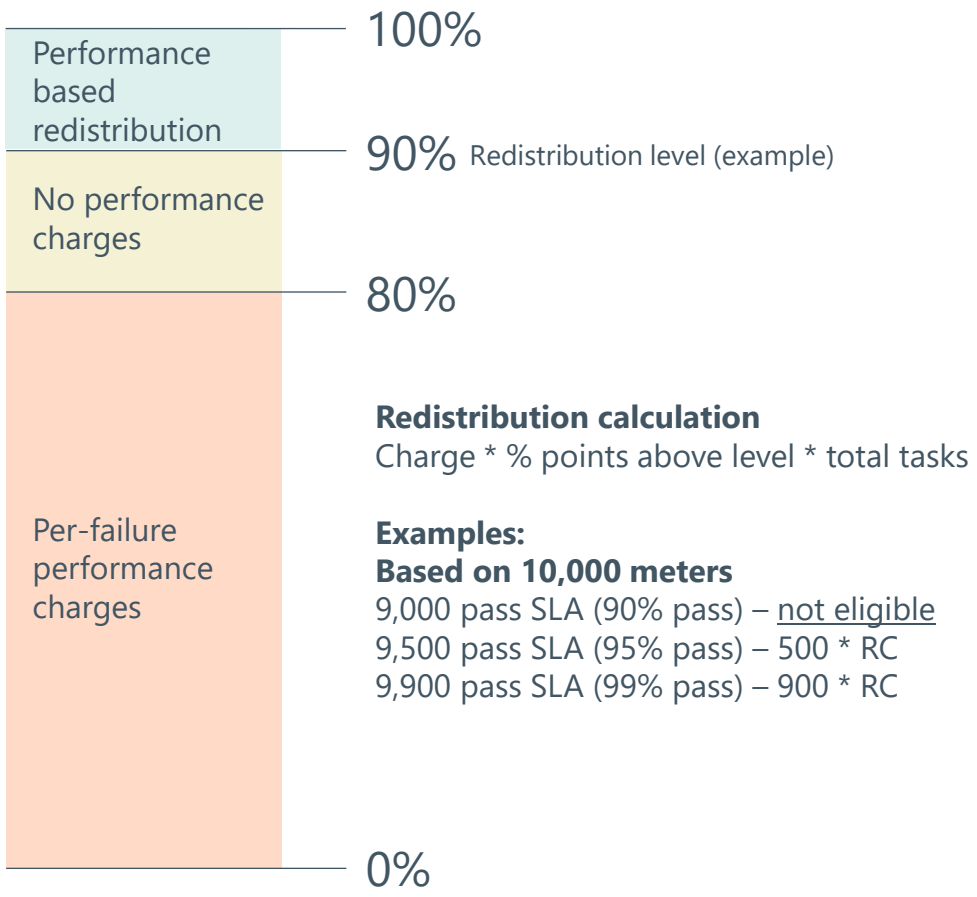
Do you have a project in mind for the Market Improvement Fund?

We are pleased to announce that the application window is **Monday 12th - Friday 28th February 2025**.

Emerging proposal

Proposal:

- MPF 2.0 will include a model of 'performance-based redistribution'. The mechanism will be the same as that proposed for 'outperformance payments'.
- Parties that exceed an overall performance level (name TBC) at year end for an applicable KPI* will qualify for this additional redistribution of penalty charges.
- 'Standard' redistribution will be preserved but is expected to be minimal.
- PBR per applicable KPI = *total tasks in year* **x** *% points above level* **x** *redistribution charge (RC)***



Redistribution calculation
Charge * % points above level * total tasks

Examples:
Based on 10,000 meters
9,000 pass SLA (90% pass) – not eligible
9,500 pass SLA (95% pass) – 500 * RC
9,900 pass SLA (99% pass) – 900 * RC

* Applicable KPIs would be the same KPIs as those proposed to have 'outperformance payments'
** This value will be variable depending on total charges made available. Redistributed amounts per KPI can be funded by penalty charges from any other KPI that applies to the same party type (i.e., Wholesaler or Retailer)

Emerging proposal

Other options considered

Reward only the top performer per KPI

- ✓ Greater certainty of material payment to best performer
- × All other 'good' performers will not be 'rewarded'
- × Unless payments are high (which introduces other issues), a large proportion of charges will still need to be returned to other parties

No additional payments/ rewards/redistribution

- ✓ Simple
- × All penalty charges minus MIF are returned so the overall impact of penalties is largely one of cashflow

Return to pre CPM018 model

- ✓ A performance-based mechanism of redistribution as set out by CPM008
- × Solution was not considered a sufficient enduring solution by Ofwat, the MPC, and Economic Insight at the time
- × Additional complexity of "charge attribution zones"

Discussion

Discussion points:

- In principle, should charges be returned to poor performers?
- Is the emerging proposal or approach under the current framework better for customers and the market? Is there a better alternative?
    - E.g., one performance-based redistribution based on holistic performance across applicable KPIs
- If the emerging proposal is preferred:
    - who should determine the proportion of penalty charges used for 'performance-based redistribution' and to apportion this across different KPIs?
    - should the 'performance-based redistribution' per KPI be offset by any charges that the TP had removed by the cap?

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General approach to setting charges and standards

How to get to a final model for chargeable KPIs

1) **Context** – establish key principles driving the KPI, confirm the background on the equivalent metric (if any) in the MPF and challenges associated with it, and explain the new KPI design
2) **Proposal** - propose values and rationale for charges and standards based on assessment of activity costs, current total market exposure to MPF charges, and impacts of poor performance to be mitigated
3) **Impact analysis** - model the proposed values for charges and standards compared to the current MPF, and test the impact of different scenarios at market and trading party levels
4) **Cross check -** reassess the proposal against the principles set out in consultation 4 and alternative options
5) **Confirm risk mitigation** – explain how risks will be managed

MOSL has suggested this structured approach for the PAG to review and suggest additional checks/process steps

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Upcoming PAG workshop(s)

Date	For discussion	Detail
6 November	Financial tools	Cap and performance-based redistribution proposals
20 November	Reporting*	Initial view of reporting requirements
27 November	Financial tools*	Follow up on cap and performance-based redistribution proposal

**Subject to change*

AOB