



19 July 2022

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Dear David,

### **Policy consultation – Strengthening financial resilience**

Ofgem is entirely right to focus on strengthening the financial resilience of suppliers. Whilst events in energy markets over the last 12 months have been challenging for all suppliers and their customers, there is no doubt the impact of the crisis on customers has been made worse by the lack of resilience which drove much of the supplier failure we saw. In particular, as the NERA analysis published alongside the consultation highlights, vulnerable customers have paid the highest price.

We strongly support the principles outlined in the consultation. Ofgem must act with urgency to introduce resilience measures, the most effective way to do this is to progress proposals to ringfence customer credit balances (CCBs) and Renewables Obligation (RO) payments as soon as possible, before the winter. Recent increases in wholesale prices remind us how precarious the situation remains; it is crucial that Ofgem sends strong signals to suppliers to operate their businesses in a sustainable way and change their business models urgently if they do not.

We wholeheartedly agree with Ofgem that the broader costs of supplier failure, the moral hazard, must be considered when assessing costs and benefits of the policy. Ringfencing CCBs and RO is not just about making sure the money is available to repay those costs in the event of supplier failure, it's about shifting away from business models where suppliers and their investors can gamble with customers' money, knowing that their capital is not at risk and customers will pick up the pieces if their gambles fail.

The NERA analysis shows that the overall cost of doing nothing is continued excessive risk taking leading to supplier failure which will cost over £20 per customer per year. As NERA and others have highlighted on many occasions, a requirement to ringfence credit balances and RO disrupts business models based on inefficient and unsustainable levels of risk-taking so addresses all of this cost, not just the CCB and RO elements.

NERA estimates the cost to suppliers of insuring CCBs and RO is a very modest £1.80 per customer per year on the assumption that suppliers change their business models to reduce risk. Even when only partially effective at reducing risk, NERA estimates the average cost to customers at £3.10 per customer per year. NERA also shows that ringfencing addresses the disproportional impact of the status quo on disengaged and vulnerable customers. There is a clear benefit to customers in taking immediate action to ringfence CCBs and RO.

It is important to note that to access finance at the rates NERA assumes, some suppliers will need to change their business models to reduce the levels of risk they take. This is the exact intent of the proposals. Ofgem must bear this in mind when reviewing suppliers' assessments of the costs of ringfencing; if suppliers continue to operate unsustainable, risky business models, the cheaper financing wouldn't be available.

Ofgem's proposals to preserve the value of insolvent suppliers' hedges are well intentioned but need more development. We note that ringfencing of CCBs and RO reduces the risk of failure overall so significantly reduces the likelihood of suppliers becoming insolvent and monetising in-the-money hedges before failing.

Ofgem's thinking on capital adequacy is at an early stage. Ofgem is right to explore this topic thoroughly to understand the risks that suppliers face and the implications for the levels of capital they should hold. Ofgem is also right to acknowledge the link between capital adequacy and supplier returns, this is a topic that needs more thorough analysis in the coming months. E.ON has always had thorough risk management controls in place and has always ensured it is sufficiently capitalised. That some suppliers have not illustrates one of the unsustainable cost advantages for those suppliers that ultimately lead to their failure. It is crucial that all suppliers are held to sufficient standards.

We set out more detailed thoughts on the issues raised in the consultation in Appendix 1.

Given the importance of this topic, we commissioned Oxera to compile an initial study looking at the levels of risk suppliers face in the market, implications for the levels of risk capital suppliers need to hold and the cost of that capital. This study shows that the levels of risk in the retail market today, largely driven by flaws in the price cap, are significant and require large amounts of risk capital to manage which is unlikely to be recovered under the current price cap. The answer is not to simply to increase the level of the price cap; Ofgem needs to strike a balance between the level of risk suppliers are exposed to (which requires capital and a sufficient return on that capital) and the overall cost to customers (which can be reduced by lowering the risks suppliers are exposed to through regulatory design). We have attached this study in Appendix 2.

Yours sincerely,

Steve Davies  
Head of Regulation

## **APPENDIX 1**

### ***Introduction***

***Question 1: Do you think that the measures we are proposing sufficiently and proportionately address our objectives? Are there other measures that you think we should consider to better meet our objectives?***

E.ON has long been supportive of Ofgem's proposals to ringfence CCBs and RO payments. We continue to believe that these are the most effective ways to remove incentives for suppliers to take excessive risk and reduce the future costs of SoLR mutualisation. Further detail is included in the cover letter above.

Although we understand Ofgem's high level proposals on hedging and capital adequacy, Ofgem needs to take a pragmatic approach to the introduction of any measures beyond ringfencing. Due to the likely impact that ringfencing CCBs and RO payments would have on supplier financial resilience, Ofgem should allow sufficient time to evaluate their impact before looking to introduce further requirements. Indeed, ringfencing supported by regular stress testing exercises, and other financial reporting as part of the Financial Responsibility Principle, may well be more than adequate to drive necessary improvements in the financial robustness of suppliers.

As Ofgem has mentioned in the consultation, there may be additional measures that could help strengthen financial resilience in the market. It is important that Ofgem weighs up the likely burden on suppliers against the likely benefits of their introduction. Recent developments in the banking and aviation sectors demonstrate many of these other measures, tested in those other sectors, have not gone far enough in terms of strengthening financial resilience. As a result, ringfencing customer money has either been introduced or is going through the consultation process.

As of 1 January 2019, the largest UK banks are required by UK law to separate core retail banking services from other activities within their group. Known as ringfencing, the process was introduced to increase the stability of the UK financial system and prevent the costs of failing banks falling on taxpayers. Furthermore, it protects the retail sector from shocks originating from other parts of the banking sector. At the time, the financial services compensation scheme (FSCS) was already in place which protects customer money up to a defined threshold.

The Prudential Regulation Authority produces an annual report which includes the Annual Competition Report. This highlights the impact that ringfencing has had on competition and gives reassurance that ringfencing in the energy supply sector would not lead to a detrimental impact on competition. The report concludes that,

*"some of the historical advantages of large banks may be starting to weaken through innovation, digitalisation, and changing consumer behaviour. Collectively, digital challengers now have around 8% market share for PCAs. Larger banks have adopted*

*digital innovation in PCA banking – led by digital challengers – and this has improved service quality for many consumers.<sup>1</sup>*”

As referenced in Ofgem’s consultation, the ATOL regime, which is managed by the Civil Aviation Authority, is currently under review. It has been recognised that existing measures such as attempts to reduce some ATOL holders’ reliance on customer money have not gone far enough. As a result, the CAA issued a consultation in April 2021 to gain stakeholder views on the segregation of customer monies in a similar way to Ofgem’s proposed approach. Although the outcome of the consultation has yet to be published, this demonstrates how other measures to improve a travel operators’ financial resilience have not gone far enough and how ringfencing customer money will go a long way to solve that problem.

The experience of the aviation and financial sectors illustrates that without genuine ringfencing of customers’ money, other measures have limited effect.

### ***Customer Credit Balances***

***Question 2: (For suppliers) What impact would ringfencing customer credit balances have on your business and to what extent could this be mitigated through transitional arrangements? Please explain your response and provide supporting evidence where possible.***

E.ON is not overly reliant on CCBs to fund its day-to-day business activities. As such, we neither envisage a significant impact on our business nor a lengthy transitional period to implement ringfencing.

Indeed, all suppliers should be in a position to implement these measures quickly. As mentioned in the consultation, the guidance sitting alongside the Financial Responsibility Principle includes a requirement for suppliers not to be overly reliant on CCBs for their working capital. This guidance became effective from 22 March 2022 so suppliers should have been taking steps to ensure they met these requirements prior to their publication. Discussions about ringfencing credit balances have been on the table for several years and suppliers have had ample time to consider how to move away from over-reliance where applicable.

It is important to note that the primary objective of the proposal to ringfence CCBs and RO payments should be to ensure suppliers are operating sustainable business models. The implementation of these proposals may be more disruptive for suppliers who continue to operate unsustainable models, relying on their customers to finance their business and relying on free insurance from other customers in the market if they fail. Nevertheless, this is precisely the purpose of them and swift action from Ofgem can quickly improve resilience of the sector in a time of continued extreme volatility.

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<sup>1</sup> [Prudential Regulation Authority Annual Report 1 March 2021–28 February 2022 \(bankofengland.co.uk\)](https://bankofengland.co.uk/prudential-regulation-authority-annual-report/1-march-2021-28-february-2022)

We do not agree with Ofgem's assessment that suppliers should be able to ringfence a minimum of 30% of their gross credit balances net of unbilled consumption, the proportion should be far greater. A supplier who is only able to ringfence Ofgem's minimum recommendation is a supplier who remains overly reliant on credit balances to fund its business and is therefore not complying with existing regulatory obligations. We understand that Ofgem needs to account for the different ways suppliers fund their business models, but Ofgem should reconsider its position on a transitional approach. Discussions on this topic have been ongoing for far too long and swift action needs to be taken to protect the market.

We also note that the wholesale market continues to show extreme volatility, with significant price rises since mid-June. This makes it even more important that business models based on excess risk at customers' expense are stopped quickly.

***Question 3: Do you agree that we should apply the Gross Credit Balance net of Unbilled Consumption definition for the purpose of ringfencing CCBs? Please explain your response and provide supporting evidence where possible.***

Yes, we agree. This approach would ensure that customer payments made to cover future energy usage is protected in the event of supplier failure.

Ofgem's objective is to remove incentives for suppliers to take excessive risk and reduce the mutualisation costs associated with failure. In the event that a supplier fails, it is not the responsibility of nor is it necessary for the new supplier to reimburse customers for anything above their credit balance position following their final bill. As such, protecting gross credit balances alone would be unnecessary. On the other hand, ringfencing credit balances net of unbilled consumption and gross debit balances would neither address the issue of suppliers taking excessive risk nor be consistent with Ofgem's main aim to develop a more resilient market; it would lead to the majority of credit balances being mutualised as they are now. It does not make sense to place an additional administrative burden on suppliers which still leaves unscrupulous suppliers free to take excessive risk with customers money and not face the consequences. It is important to remember that these proposals, if implemented correctly, will not just protect CCBs and RO payments but also reduce the likelihood of supplier failure, delivering a benefit of over £20 per customer per year. This will not be possible should Ofgem decide to include debit balances in their calculations.

Furthermore, Ofgem should refer back to the Reducing Credit Balance Mutualisation RFI, issued in July 2021, where suppliers provided data about their credit and debit balances. This data demonstrates that there will be periods throughout the year where CCBs are effectively cancelled out by the level of debit balances. If this situation was present at the time of a SoLR there wouldn't be any ringfenced funds to transfer to the new supplier even though there would be a large proportion of customers whose account would have been in credit at the time of going into insolvency.

Customers should be able to ask for their credit to be returned at any time and, if all customers were to ask for their credit back at the same time, suppliers should be able to honour them regardless of the debit position of other customers. It's unlikely that ringfencing credit balances net of debit balances would ensure this.

It is important to understand that, even though a supplier may have a level of debt, it could still be using the CCBs of other customers to fund its business activity. Customers join suppliers at different times of the year and Direct Debits should be set to try and return the balance to as close to zero as possible every 12 months. As a result, customers will have varying levels of debit balances throughout the year, but this doesn't mean that the customer is in debt. In addition, the creditors of an energy supplier will all have their own payment terms which can vary significantly (e.g. 2 weeks to several months) meaning that, if supplier debts are not required to be paid immediately, credit balances could be diverted elsewhere to fund other activities.

In the event of supplier failure, debit balances are only worth what can actually be collected from customers. We note that in recent SoLRs the administrators placed a very low value on debit balances, reflecting the challenge in recovering the debt. Netting off debit balances when ringfencing is therefore likely to result in a significant shortfall if a supplier subsequently fails.

Netting off debit balances would also bring a number of unintended consequences. It rewards suppliers who are worse at collecting debt – this is likely to be detrimental to their customers. It could also encourage some suppliers to increase debit balances in others ways that are detrimental to customers to offset their credit balances (such as raising tariffs higher than they otherwise would).

To further reinforce Ofgem's preferred approach, it is worth referring back to the licence definition of customer credit balances which is as follows; *"the amount by which any payment made by the Customer to the licensee under or in accordance with the relevant Domestic Supply Contract and/or Non-Domestic Supply Contract which exceeds the total amount of Charge which is due and payable by the Customer to the licensee under that Domestic Supply Contracts and/or Non-Domestic Supply Contracts minus any amount refunded to the Customer"*. Debit balances are not referenced within this definition and, once taken into consideration, the level of money being ringfenced would not be reflective of the overall credit that a segment of a supplier's customer base had accrued. In addition, the increase in the price cap and overall increase in the cost of living could impact the scale of debit balances even further.

***Question 4: Do you agree with our view that the Protection Amount Calculation should be updated quarterly and based on backward-facing data, forward-facing projections, or a combination of the two? Please explain your response and provide supporting evidence where possible.***

No, we do not agree with Ofgem's preference to protect an amount based on forward-facing data, forecasting the peak CCBs on a quarterly basis. For the proposal to be as

effective as possible and deliver the significant benefits outlined in the impact assessment, it needs to be based on the best view of the level of insurance a supplier needs. Due to the complexities involved with forecasting consumption, a forward-facing approach will lead to an amount being protected which is either too low or too high when compared to the actual peak. There are a number of variables, particularly customer behaviour and the weather, that significantly impact energy consumption making it difficult to accurately forecast the level of CCBs to be protected.

This approach would be much more burdensome than other options due to the added complexity that a forecasted approach would bring. The methodology could be open to interpretation and leave suppliers to come to different conclusions on the amount to be ringfenced whilst attempts to bring in a consistent methodology could be challenging due to the differing ways suppliers report data.

To ensure maximum effectiveness of the proposals, and deliver the maximum benefit to customers, suppliers should calculate the amount to be protected on a monthly basis based on actuals. Not only will this simplify the methodology for calculating the amount to be protected (once implemented we do not envisage this to be burdensome), it will also ensure accurate CCBs are protected and updated regularly.

### ***Renewables Obligation***

***Question 5: Do you agree that option 3 ('protect or discharge through ROCs' obligation) is the best approach for addressing supplier payment default under the RO - and if not, what is your preference and why?***

In the absence of legislative change to require suppliers to settle their renewable obligation (RO) more frequently, we agree that option 3 (protect or discharge) is the best approach.

The approach summarised in the 'report and protect' option (option 1) will not prevent suppliers from defaulting on their RO payments. Ofgem should learn from experience that only a proactive compliance and monitoring regime will help to prevent suppliers from taking excessive risk. This option would not disincentivise them from doing so as they would still be free to divert customer money to fund other activities if they begin to experience financial difficulties. It's likely that Ofgem would find out too late to implement any remedial actions.

Option 2 (protect) could, as Ofgem says, lead to suppliers changing their strategy for purchasing ROCs which could be detrimental to all parties concerned. We agree with all of the issues raised by Ofgem in relation to this option and there would be a requirement to reconsider how we interact with the ROC market should this option be introduced.

***Question 6: How, and to what extent, would a requirement to protect your RO impact your business and the way you currently interact with the scheme? If we were to ask***

***suppliers to create a trust in favour of Ofgem over the proceeds of sale of ROCs, do you foresee any challenges with this and would it disincentivise you from buying ROCs?***

✂. As mentioned in our response to question 2, it is important to note that the primary objective of the proposal to ringfence CCBs and RO should be to ensure suppliers are operating sustainable business models. The implementation of these proposals may be more disruptive for suppliers who continue to operate unsustainable models, relying on their customers to finance their business and relying on free insurance from other customers in the market if they fail. Nevertheless, this is precisely the purpose of them and swift action from Ofgem can quickly improve resilience of the sector in a time of continued extreme volatility.

✂. We would welcome continued dialogue with Ofgem as these plans are further developed to work through the best ways to maintain commercial flexibility and allow suppliers to continue to optimise their position.

***Question 7: How, and to what extent, do you think a requirement to protect your RO would impact the ROC market?***

Ofgem's preferred option does not have any material effect on the operation of the scheme and brings about the necessary improvements and robustness to avoid and/or mitigate the mutualisation risk. By minimising disruption to the operation of the RO market, Ofgem's preferred option will preserve liquidity whilst giving confidence that suppliers throughout the year will be able to meet their full obligation requirements.

There will be those in the industry who will make the argument that the proposals are a bad thing and will disrupt competition. We strongly refute this, and indeed would argue that it is precisely the outcomes we have seen over recent years with supplier defaults which cause the greatest impact on supply competition and crucially how this effects customers. As we enter this winter, the underlying market conditions are extremely difficult and demonstrate why reform as advocated in this consultation is essential. If such reforms were already in place, the consequences of the disruption we are already seeing in the market today would be reduced.

***Question 8: Do you agree the proposal should be effective from April 23? Do you see any issues or concerns with the transitional phases we have laid out?***

As mentioned earlier in the response, E.ON has long been supportive of Ofgem's proposals to ringfence credit balances and RO payments. Our view is that changes should be introduced as swiftly as possible and agree the beginning of the next scheme year is a suitable time to implement them. We are also in favour of a more robust monitoring scheme in the interim.



***Question 9: What, in your view, would be the appropriate frequency of the reporting requirement: once an obligation period or quarterly?***

We believe that quarterly reporting strikes the right balance between ensuring adequate RO protection is in place and a proportionate administrative burden on suppliers. As mentioned in previous responses and as evidenced in various reports, such as Oxera's Review of Ofgem's Regulation of the Energy Supply Market, Ofgem needs to make sure that a proactive compliance and monitoring regime is in place to ensure the mistakes of the past are not repeated.

#### ***Chapter 4: Protection Mechanisms***


***Question 10: Do you agree with suppliers being able to select from a menu of protection mechanisms and do you agree with the mechanisms we are considering?***

Yes, Ofgem's approach in creating a menu of options is sensible and strikes the right balance between giving Ofgem confidence that ringfencing is genuinely providing protection and giving suppliers some degree of flexibility in how they meet the requirements. The key test is that suppliers' and their investors' capital must be at risk, rather than their customers. This is how the objective of the proposals, to reduce moral hazard, will be delivered.

***Question 11: Do you agree with the minimum requirements set out for each protection mechanism and do you have any further comments on the protection mechanisms or the guidance that should be provided on them?***

We agree with the high-level minimum requirements and would welcome further dialogue with Ofgem as the detail for each mechanism is developed. The consultation references the use of templates for various submissions and while we are in favour of a standard, simple approach to submitting data, it is important that any templates are designed for long-term use. We have experience of engaging in lengthy negotiations on an annual basis to make changes to templates and steps to remove this burden would be welcomed.

***Question 12: Do you consider that suppliers would be in a position to obtain suitable insurance to protect CCB or RO funds, and, if so, do you think that this would be competitively priced?***

 , given that it does provide insolvency remote protection, other suppliers may find value in keeping it to retain flexibility in the options provided.

## **Chapter 5: Hedging**

### ***Question 13: What do you consider would be the impact on your business and the wholesale market of implementing the two options we set out and how might these be mitigated?***

In the absence of appropriate protections in the Insolvency Act, we understand the intentions of Ofgem's early proposals in this area. We are, however, mindful that measures would need to be extremely robust to ensure those intentions are achieved. We believe that only changes to primary legislation would be sufficient to support Ofgem achieve its aims. We do note, however, that many of the benefits to customers of this proposal will be delivered by a robust requirement to ringfence CCBs and RO (which encourages suppliers to operate lower risk models and reduces the likelihood of failure overall). Whilst we are not opposed to Ofgem's proposals here, once robust ringfencing of CCBs and RO is in place, the additional benefits of this proposal are likely to be limited.

With regards to the contractual change option, we believe that its implementation would cause little disruption to suppliers but agree with Ofgem that it is not clear that it could actually be relied upon in the event of insolvency.

The licence change option is likely to be more effective at delivering Ofgem's objectives, but the administrative costs of setting up and managing a trust account for 'in the money' hedges would be extremely complex. It is not clear what an "in-the-money" hedge really is for the purpose of this proposal. Ofgem defines an in-the-money hedge as contracts with a positive value because they allow purchase of gas or electricity more cheaply than the prevailing market price. Liquidating that hedge can create a windfall as Ofgem outlines, but this is not the same as the hedging cost a SoLR would incur when taking on that supplier's customers. The true value that needs to be preserved to minimise the cost of mutualisation is the difference between the market value of a supplier's hedged position (assuming it had hedged for all of its customers) and the price at which a SoLR would be required to sell it to customers (i.e. the energy cost component of the price cap). We would be happy to discuss the challenges with Ofgem in more detail.

### ***Question 14: Are there other options to more effectively reduce the wholesale costs to consumers of supplier insolvencies?***

As outlined above, the proposals to ringfence CCBs and RO themselves will reduce the wholesale costs to consumers of insolvencies by reducing the number of insolvencies themselves. This conclusion is clear from the analysis NERA has done, published alongside the consultation.

Whilst we are not opposed to further action in this area, Ofgem must prioritise the introduction of a requirement to ringfence CCBs and RO which would deliver the vast majority of the benefits here.

## **Chapter 6: Capital Adequacy**

***Question 15: What are your views on our proposed high level approach to a capital adequacy framework? Do you agree that capital adequacy requirements would be required in addition to our ringfencing proposals?***

In principle we agree with Ofgem's high level approach to a capital adequacy framework. However, our view is that the ringfencing proposals themselves are the first and most robust step in introducing capital adequacy requirements for suppliers.

We note that many of the benefits of capital adequacy, as highlighted by Ofgem, could be delivered by ringfencing as it requires suppliers to change their business models and manage risks more responsibly. As a result, suppliers are likely to increase the levels of capital they hold to manage risk. This in turn would enable those suppliers to access cheaper capital, and level the playing field as highlighted in the NERA report. Furthermore, these proposals can be introduced swiftly and consistently across the market.

At this stage it is too early to determine whether Ofgem's proposals on capital adequacy would be required following the implementation of ringfencing. Ofgem should first review the impact of implementing its ringfencing proposals before making a decision on further measures. Regular stress tests which have been recently introduced by Ofgem should go a long way to informing Ofgem about suppliers' financial strength and help guide next steps.

***Question 16: Do you agree with our suggestion that a capital adequacy framework should take a segmented approach – with measures implemented in a proportional way for different segments of the market, largely based on the level of risk that a company could pose to the market?***

Yes.

***Question 17: What risks do you think are most appropriate to target with a capital adequacy regime? What risks do you currently target in your internal risk assessments and risk capital determinations?***

In paragraph 6.35 of the consultation Ofgem lists material risks facing energy suppliers. We agree that each of these risks are significant and seem a good basis for a capital adequacy regime.

One additional risk not captured by Ofgem is regulatory risk itself. This likely manifest in each of the other categories but it is important to highlight that the risk of unintended consequences of existing regulation, or changes to regulation, is significant.

***Question 18: Do you have any views on the level of financial resilience that a capital adequacy regime should seek to target? What are your views on an appropriate time horizon for calculating capital requirements? What time horizons do you use in internal risk management?***

We have provided some high-level thoughts in answer to this question. We would welcome further dialogue with Ofgem to discuss in further detail.



A suppliers' going concern statements will highlight potential issues. If an audit highlights a significant issue, the supplier should be putting money aside to protect their position.

Measures should be proportionate to the size of the market, organisation, risks, risk approach and risk management. Some suppliers are likely to have a strong risk management process whereas other suppliers may not and are therefore higher risk. Any future regime should reflect this.

***Question 19: What type of capital should be included under capital adequacy requirements and what criteria could be used to determine this? How do you currently define what can be considered as sufficiently loss-absorbing capital for unexpected shocks in internal risk management?***

Due to the timescales for responding to this consultation we have focussed on ensuring we have shared our positions on the CCBs and RO payments proposals. Capital adequacy is a complex subject and, although we have provided responses to some of the earlier questions, this question requires further, in depth thinking prior to sharing our views with Ofgem. We would be happy to explore this topic in more detail through further dialogue with Ofgem at a later date.

## ***Chapter 7: Impact Assessment***

***Question 20: Do you have any views on our analysis of the impact of our proposals?***

The NERA study published alongside the consultation is an extremely thorough analysis of the costs and benefits of the proposals. We agree that the benefits of the proposals should be measured as a reduction in all mutualised costs of failure (i.e. including hedging) given that the effect of the policy is to reduce excessive risk-taking and the likelihood of failure.

In its impact assessment, Ofgem highlights the theoretical equilibrium view of costs and assumes the policy is only partially effective, this is the most conservative scenario in the NERA analysis. Even with the conservative assumptions made by NERA in its analysis (highlighted below), and Ofgem's use of the most conservative scenarios using those conservative assumptions, Ofgem's impact assessment still highlights a significant benefit

to customers. This is still the case even if removing the impact of hedging and focussing on the costs of CCBs and RO alone. This illustrates how clear the case for urgent action is.

As Ofgem highlights, the NERA analysis also shows a clear benefit for disengaged customers who are likely to be vulnerable and who have shouldered the burden of costs in the current regime. Even if the financial impact assessment were neutral overall (which it clearly isn't), this would arguably be justification in itself to implement the policy.

We agree with the assumption in the impact assessment that costs to suppliers of ringfencing are driven by the interest rate applicable to suppliers. We also agree that this interest rate is a function of a supplier's credit rating. We accept that some suppliers may need to change their business models in order to access these interest rates and achieve the level of cost assumed in the impact assessment. But this is entirely the point of the policy: to internalise the cost of excess risk taking and provide a financial incentive to reduce excess risk-taking.

Appendix B of the NERA analysis sets out sensitivities that further illustrate the benefits of the proposals. A number of these sensitivities, in particular B1 (higher market share of small suppliers) and B2 (large suppliers engage in risky behaviour in the absence of the policy) illustrate additional benefits in realistic scenarios, particularly in the equilibrium view. The NERA report itself highlights that even these sensitivities are likely to be conservative. This shows that the result from the main NERA report and included in Ofgem's impact assessment are likely to be conservative estimates of the overall benefit to customers.