

## Guidance on the Financial Responsibility Principle

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This document provides suppliers the guidance on how they should comply with their obligations under SLC 4A, the Operational Capability Principle; SLC 4B, the Financial Responsibility Principle; and SLC 4D on Protecting Domestic Customer Credit Balances (where directed to do so), as well as information on how the principles are implemented and fit within our existing regulatory framework.

**This version of the guidance is for consultation. We welcome views on our proposed changes by 3 January 2023.**

The document is intended to supersede the original Financial Responsibility Principle guidance document, most recently updated in May 2022. This guidance would be given effect by direction as set out in the proposed modifications to the

licence in our statutory consultation Strengthening Financial Resilience<sup>1</sup>. Subject to these consultations, we intend to publish a final version of the guidance in line with the appropriate process following our decision on this statutory consultation. We invite stakeholders to submit comments on any aspect of this proposed guidance on or before 3<sup>rd</sup> January 2023.

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## Contents

<b>1. Introduction .....</b>	<b>4</b>
What is the OCP? .....	5
What is the FRP? .....	5
<b>2. Implementation .....</b>	<b>7</b>
<b>3. Expectation of suppliers .....</b>	<b>9</b>
Guidance on the Operational Capability Principle .....	9
Guidance on the Financial Responsibility Principle .....	9
Holding sufficient Liquidity and Capital to meet liabilities as they fall due.....	9
Orderly Market Exit, cost Mutualisation and asset control .....	13
Minimum Capital Requirement and Alternative Source Conditions .....	16
Reporting requirements.....	19
Annual Adequacy Self-Assessment.....	19
Reporting triggers .....	25
Financial monitoring .....	27
Directing the Protection of Domestic Customer Credit Balances .....	29

## 1. Introduction

1.1. The Operational Capability Principle (SLC 4A) obligates a supplier to ensure that it has and maintains robust internal capability, systems and processes to enable it to serve efficiently and effectively each of its customers. The Financial Responsibility Principle (SLC 4B) is a set of enforceable overarching rules requiring suppliers to take action to ensure that: they can meet their reasonably anticipated financial liabilities as they fall due; they therefore minimise costs at risk of being Mutualised in the event of payment default and / or market exit; they maintain Sufficient Control over any Material and Economic Asset used to meet their obligations under SLC 4B and do not dispose of said assets if doing so risks an increase in costs at risk of being Mutualised; and that, from 31 March 2025 onwards, they maintain the 2025 Minimum Capital Requirement.

1.2. SLC 4B also puts in place: payment, loan and asset transfer requirements where certain Trigger Points occur or where the licensee does not meet the 2025 Minimum Capital Requirement; monitoring and reporting requirements; and a power to direct suppliers to Protect Domestic Customer Credit Balances (CCBs) in accordance with SLC 4D in certain circumstances. SLC 4D requires the suppliers to put in place and maintain arrangements to Protect a specified proportion of their CCBs. While certain elements of SLC 4A, 4B and 4D apply only to domestic suppliers, this Guidance is relevant for all domestic and non-domestic suppliers.

1.3. Ofgem<sup>2</sup> previously issued guidance under SLC4B in May 2022. This new Guidance – which supersedes our previous guidance - replaces that guidance and has been issued, pursuant to SLC 4B.14, to assist stakeholders in understanding these licence conditions. As noted in those standard conditions, before issuing this Guidance by direction, we will publish it on the Authority’s website along with the date in which we intend for it to come into effect. We will allow a period of not less than 10 working days for representations in relation to the content of the Guidance. We remind all suppliers that this Guidance does not modify or replace the conditions in the gas and electricity supply licences. Neither is it an exhaustive list of supplier obligations. Suppliers should continue to refer to the conditions outlined in the most recent versions of the gas and electricity supply licences.

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<sup>2</sup> The terms “we”, “us”, “our”, “Ofgem” and “the “Authority” are used interchangeably in this document and refer to the Gas and Electricity Markets Authority. Ofgem is the office of the Authority

1.4. In accordance with its powers under the licence, the Authority may amend this Guidance by direction in accordance with SLC 4B.14 and 4B.19.

1.5. The purpose of this Guidance is to help the licensee comply with their licence obligations, including the obligation to prepare and submit information pursuant to 4B.12 and 4B.13. We have included in section 3.91 of this Guidance, templating details for the information required under SLC 4D.8 for Credit Balance Support Arrangements and SLC 30 for RO Credit Cover Mechanism(s).

1.6. Where defined words and expressions are used in this Guidance, they are capitalised and have the same meaning as in SLCs 4B, 4D and 30.

## **What is the OCP?**

1.7. The aim of the Operational Capability Principle is to ensure that suppliers have the appropriate systems and processes to provide a quality service to their customers, meet their regulatory obligations and bear an appropriate share of their risk.

1.8. It is a broad requirement on suppliers to serve customers effectively and have the capability to meet all relevant legislative and regulatory obligations. We are providing additional Guidance on how suppliers should comply with this principle in relation to one specific area where we have identified risks to consumers. We are clarifying our expectations on the level of control we expect suppliers to have over the material economic and operational assets they use or need to run their businesses. We identified the need for this additional Guidance through our work to promote financial resilience in the retail market.

## **What is the FRP?**

1.9. The Financial Responsibility Principle acts as an over-arching obligation to ensure suppliers act in a financially responsible manner, meaning they properly manage risk, are well-capitalised and able to withstand severe but plausible financial stress. This principle sets out a Minimum Capital Requirement and allows Ofgem further regulatory powers to take enforcement action where we see irresponsible behaviours in the market.

1.10. To strengthen retail financial resilience, we want suppliers to bear an appropriate share of their risk, including by adopting responsible financial management approaches and

holding sufficient Capital and Liquidity to ensure suppliers are resilient enough to withstand future shocks, and to minimise the extent of cost Mutualisation in the event of their failure.

1.11. Suppliers without sufficient Capital and sustainable business models are vulnerable to market shocks, making them more susceptible to failure. They are also more likely to pursue excessively risky strategies because they are less reliant on investor Capital. Features of the retail energy market mean that some supplier costs are at risk of being Mutualised upon its failure if they are not managed responsibly while the supplier is trading. Customer credit balances, network charges and environmental and social scheme obligations are examples of this. This can give rise to very poor outcomes for consumers and systemic risks to the retail supply market, even in circumstances where the majority of suppliers do not rely on such unsustainable business models

1.12. Our overarching objective is to protect current and future consumers by developing a more resilient energy supply market. We want to remove incentives for excessive risk-taking with consumer money whilst enabling an environment for investment and sustainable competition, at the lowest overall cost to consumers. This will ensure that consumers, energy suppliers and investors can have confidence in the energy supply market going forward.

## 2. Implementation

2.1. The Financial Responsibility Principle (FRP) and the Operational Capability Principle (OCP) were introduced into the gas and electricity supply licences in early 2021. We amended the FRP and OCP on 26 August 2022 to set out that suppliers should have sufficient control of their material and economic assets<sup>3</sup>. The FRP was modified in [2023] following our Strengthening Financial Resilience statutory consultation<sup>4</sup> published on 25 November 2022. As set out above, the FRP sets out what suppliers must do to ensure that they are sufficiently financially resilient to survive market shocks / minimise costs at risk of being Mutualised where they do fail. These more specific requirements help suppliers by providing clarity around what they must do to ensure compliance with their financial responsibility obligations and helps protect consumers by ensuring that the Authority can intervene appropriately and early where there is evidence that a supplier is not meeting those obligations.

2.2. To facilitate early intervention by the Authority where appropriate, the FRP also requires suppliers to notify the Authority before it makes non-essential payments, loans or asset transfers in circumstances where it does not hold the 2025 Minimum Capital Requirement or where certain Trigger Points have occurred (see paragraph 3.66 of this Guidance). This requirement enables the Authority to work with a supplier in managing its financial outgoings where that supplier is not sufficiently financially resilient or, where appropriate and necessary, take enforcement action requisite to bring the supplier back into compliance with the FRP or other obligations.

2.3. The Authority has a range of statutory and licence-based information gathering powers which it currently uses to ensure that it has oversight of supplier compliance with the FRP and other obligations. To provide suppliers with a clear understanding of information that the Authority requires and when it is likely to require it, the FRP includes monitoring and reporting requirements. These requirements are explained in more detail from paragraph 3.36 of this Guidance. Where suppliers do not achieve certain financial resilience standards within the FRP, the Authority has the power to direct the supplier to Protect its CCBs in accordance with SLC 4D. This power will help suppliers manage their

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<sup>3</sup> [Decision on statutory consultation on supplier control over material assets | Ofgem](#)

<sup>4</sup> [Statutory Consultation - Strengthening Financial Resilience | Ofgem](#)

finances so that they do not rely on customer money to survive in the market. It also ensures that where that supplier does fail a proportion of CCBs are protected in a manner designed to ensure that they pass to a Special Administrator or Supplier of Last Resort (“SoLR”) and are not Mutualised and ultimately passed back to consumers through higher bills.



### 3. Expectation of suppliers

#### Guidance on the Operational Capability Principle

3.1. SLC 4A obligates a supplier to ensure it has and maintains robust internal capability, systems and processes to:

(a) efficiently and effectively serve each of its Customers;

(b) efficiently and effectively identify likely risks of consumer harm and to mitigate any such risks; and

(c) comply with relevant legislative and regulatory obligations.

3.2. These rules mean that a licensee must have sufficient control over all of its material economic and operational assets necessary to maintain robust internal capability, systems and processes, e.g. premises, facilities, staff, equipment, IT system and brand name, used or needed to run its supply business.

3.3. The requirement to maintain robust capability, systems and processes means that a regulated supply entity must own and/or have sufficient control over all the operations used or needed to run their supply businesses. Sufficient control means that a regulated supply entity has legally enforceable rights over the material assets it requires to operate its business, so that it can rely on those assets legally and enjoy the benefit of them. This means, for example, it does not rely on informal intra-group arrangements or the goodwill of third parties as such arrangements may be able to be terminated at will. Suppliers cannot efficiently and effectively serve their customers or identify and mitigate risks to those customers where they have insufficient control over their operational capacity.

#### Guidance on the Financial Responsibility Principle

##### Holding sufficient Liquidity and Capital to meet liabilities as they fall due

3.4. Under the FRP, all suppliers – domestic and non-domestic - are required to maintain Capital and Liquidity of sufficient amount and Quality that they are able to meet their reasonably anticipated financial liabilities as they fall due on an ongoing basis. Although domestic suppliers are also required to meet a Minimum Capital Requirement, this requirement is intended to represent the minimum amount of capital that should be held by

suppliers as a whole, and does not indicate the proper amount of Capital or Liquidity an individual supplier should have on hand to be resilient in light of its specific business strategy and risks. It is for the supplier to determine (and be able to justify to the Authority) what Capital and Liquidity they may need in addition to the minimum amount to be able to meet their reasonably anticipated financial liabilities as they fall due in times of severe but plausible financial stresses.

3.5. A supplier should make its assessment of adequate financial resources on a fair valuation of both assets and reasonably anticipated financial liabilities, considering timing of cash flows under severe but plausible scenarios that the specific business could face. In carrying out this assessment, a supplier should consider whether it has sufficient Capital and Liquidity to cover the nature and level of risks to which it might reasonably anticipate being exposed. In doing this, it should consider which of at least the following risks are relevant to its business, and how these risks could impact its Liquidity and Capital needs considering severe but plausible stress. For avoidance of doubt, the list below is a non-exhaustive list, and it is the responsibility of the supplier to clearly identify all relevant risks to its business model which need to feed into its decisions on necessary Capital and Liquidity to remain compliant with the FRP.

- **Price risk:** The risk that financial losses may occur due to changes in commodity prices. Price risk can be considerably reduced by hedging, where suppliers purchase energy for delivery on future dates on pre-agreed pricing terms, protecting the supplier from the volatility of price fluctuations on the cost of wholesale gas and electricity. Conversely, where suppliers are contracted to sell energy at a fixed price to customers but do not have all volumes contracted, they may need to continue delivering lower prices even as the prices they pay to purchase energy at rise. Suppliers can also be affected by falling wholesale prices when they have future commitments to buy energy at fixed prices, or can be exposed to market moves in either direction where trading speculatively.
- **Churn/volume/demand risk:** The impact of significant changes in customer numbers and/or customer demand. For example, unexpected weather conditions can leave suppliers over- or under-hedged to meet demand and require them to secure supply they did not anticipate needing, or leave them with excess supply. Customer churn can also affect the extent to which a supplier can recover operating costs, given that it might lose income from customers who leave before it sees any decrease in its operating costs as a result of the departing customers.

- **Counterparty credit risk:** Relates to the risk that a counterparty to a transaction could default before final settlement, which can result in losses. For example, in the event a hedge counterparty fails, a supplier may have to re-hedge – potentially at higher prices. This may have particular risks if, for example, a supplier relies heavily on an external trading arm to procure supply and hedges, and that trading arm fails. Or, in the event a supplier has a Power Purchase Agreement (PPA) or Gas Supply Agreement (GSA) in place and the counterparty fails to deliver on that PPA and GSA.
- **Credit risk:** Consumers may not always be able to pay their bills in a timely manner, in which case suppliers will take on increasing levels of “bad debt.”
- **Liquidity risk:** Relates to the inability to meet payment obligations as they fall due. A major source of Liquidity risk is that in a stressed market, some suppliers will face increasing costs associated with posting collateral for trades.
- **Other market risks:** Beyond these major categories, there are a variety of other risks that could be associated with procuring energy, such as foreign-exchange risk and interest rate risk. Suppliers should also have regard for tail risk, which relates to the chance of a loss occurring due to a highly unlikely or rare event.
- **Operational risk:** risks associated with shortcomings in governance; reputational risk; business disruption and IT risks. Suppliers should also have regard for any risk related to its association with a group – for example if the firm may be adversely affected by its relationships – financial or non-financial – with other entities in the group or by risks which may affect the financial position of the whole group.

3.6. The supplier should consider how it intends to deal with each of the distinct risks its business is subject to and give appropriate consideration to the relationship between these risks (for instance where they may be correlated in extreme events). Where a risk is not obviously quantifiable – e.g., certain types of operational risk – a supplier should consider the best mitigation, and whether holding additional Capital or Liquidity could be an appropriate response until the risk is eliminated or reduced.

3.7. The supplier needs to consider the Quality of financial resources it has on hand to meet liabilities as they fall due. What this means is that the supplier needs to consider the loss absorbency of Capital it has available to draw on to absorb unexpected losses. In the

case of Liquidity, a firm should consider the extent to which a resource can be converted to cash as soon as needed and with minimal loss in value.

3.8. The supplier also needs to consider the risks associated with any funding sources that are a form of debt, and those which are not held by the licensee itself. To help inform its evaluation of these sources of funding and frame its reporting to Ofgem, the supplier should consider the criteria set out by Ofgem for suppliers wishing to propose the use of alternative sources of funding to meet the Minimum Capital Requirement (see paragraph 3.30).

3.9. For example, to the extent any of the sources of funding it anticipates having on hand to cover risks are held at group level or elsewhere within the group, the supplier should ensure there are no overly restrictive limitations on the ability to transfer capital to the specific licensee when needed, including in times of stress to the group, other entities to the group, or to the supplier itself. The supplier should also consider what internal capital distribution might result in terms of any resources being ringfenced in the event of insolvency.

3.10. Although official reporting on a supplier's financial adequacy is expected to take place annually (as set out in paragraph 3.37), suppliers should be aware on an ongoing basis of their Capital and Liquidity position against their risks and be able to demonstrate compliance with the FRP at any time. The supplier should also carry out an evaluation to ensure that the level of Capital and Liquidity it holds to meet the FRP remains comprehensive, and proportionate to the nature, scale and complexity of the supplier's activities. For example, as a supplier grows or introduces new products or new pricing strategies, its evaluation processes should evolve to ensure that they account for those in assessing FRP compliance.

3.11. We will consider, on a cumulative basis, a range of Supervisory Financial Reporting such as Market Compliance Reviews<sup>5</sup>, stress tests and other financial monitoring and Milestone Assessments<sup>6</sup> (where relevant) to complement supplier self-assessment reporting and enhanced financial monitoring to inform our position on supplier resilience. This

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<sup>5</sup> These are where the Authority gathers and analyses information from licensees regarding their compliance with particular obligations. Following this analysis, the Authority may publish its findings and the degree of compliance achieved by individual suppliers.

<sup>6</sup> Under Standard Licence Obligations 28C

integrated picture of a supplier's resilience will underpin our assessment of a supplier's compliance with the FRP and any subsequent decision on how to respond.

3.12. When Ofgem makes an evaluation on compliance with the FRP, it will take into account a range of considerations regarding the supplier's own assessment informing their Capital and Liquidity levels, including but not limited to the following:

- Whether the data and analysis informing the Capital and Liquidity assessment is sufficiently sophisticated considering the supplier business model and risks.
- The policies and processes a supplier has to identify, measure and manage the Material sources and effects of relevant risks.
- Whether the supplier sufficiently identified and considered the range of risks it is exposed to and interactions of those risks, how those risks are likely to evolve, and whether the supplier has considered the impact of severe but plausible stress scenarios on those risks.
- Whether the supplier has sufficiently considered and made reasonable assumptions about the risks associated with its identified sources of funding to meet the FRP.
- Whether the supplier has sufficiently considered how it is impacted by its association with a group or other entities in the group.
- The involvement of senior management in the process, and clear ownership of risks and mitigations amongst senior management.

### **Orderly Market Exit, cost Mutualisation and asset control**

3.13. Under the FRP, suppliers are required to ensure that were they to exit the market, the exit would be an Orderly Market Exit. We define this in the SLC as meaning that the supplier should ensure that its financial and operational arrangements are such that any SoLR or special administrator appointed on the supplier's exit would be able to efficiently and effectively serve its customers and that the exit would not result in Material Mutualised costs.

3.14. Suppliers must therefore have sufficient systems and controls in place to identify, monitor and where practicable reduce Material potential harms that could result from the supplier's exit from the market, both to its own customers as well as to the wider Consumer Interest. Where no alternative actions are available to mitigate those harms, a

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supplier should consider whether they need to hold additional Capital or Liquidity to help mitigate those harms.

3.15. Closely connected to the requirement on suppliers to ensure that any exit from the market is an Orderly Market Exit is the obligation on suppliers to manage responsibly costs that could be Mutualised and to take appropriate action to minimise such costs.

3.16. A supplier must have the ability to meet its financial obligations while not being overly reliant on CCBs for its working capital. We expect a supplier to achieve this by:

- Being able to accurately determine the total amount of sums it holds in customer credit balances (the “Credit Balance Amount”) at any point in time.
- Having risk management controls, processes, and procedures in place to minimise the risk of the Credit Balance Amount being Mutualised. We would expect these to include arrangements for the management of a supplier’s business so that it is predominantly reliant on investor capital and does not put at risk the Credit Balance Amount. In any event, suppliers must at all times ensure that they comply with the other elements of the FRP including holding sufficient Capital and Liquidity in accordance with SLC 4B.1 and holding the 2025 Minimum Capital Requirement.

3.17. Without prejudice to the generality of the meaning and application of SLC 4B, we would expect a supplier to have, and to be able to provide evidence to us on request that it has, the following in place to demonstrate compliance:

- Plans to meet its financial obligations under government schemes by relevant dates and the ability to fulfil those plans.<sup>7</sup>
- Effective processes, that are consistent with existing licence requirements,<sup>8</sup> for example setting direct debit levels and for checking and returning customer credit balances.<sup>9</sup>

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<sup>7</sup> The Financial Responsibility Principle covers both costs that could be Mutualised following supplier failure and those that may be Mutualised if paid late. For instance, any Renewables Obligation buyout fund payments that are not made by the end of October will be Mutualised whether or not the supplier has failed

<sup>8</sup> For example SLC 0 - “The Standards of Conduct”, SLC 31F/31I - “Informed tariff and consumption choices”, SLC 27.15 - “Setting Direct Debits”, and SLC 27.16 - “Refunding customer credit balances on request”.

<sup>9</sup> Under Standard Licence Obligations 27.15 and 27.16.

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- Sustainable pricing approaches that allow it to cover its costs over time, or if it is pricing below cost that the risk sits with investors and not consumers. We will need to see evidence that suppliers can finance their overall business plans.
- Robust financial governance and decision-making frameworks in place.

3.18. The Authority has set a monitoring threshold for monitoring CCB reliance, which requires suppliers to notify Ofgem as soon as reasonably practicable when Gross CCBs net of Unbilled Consumption represent the equivalent of 50% or more of their total assets, and as soon as reasonably practicable when they become aware there is a Material risk of this occurring. Once notified, we will consider the notification alongside the range of information we already collect on that supplier and make an assessment on further action, including considering whether a direction to Protect its CCBs is appropriate.

3.19. As set out in the licence, where a supplier uses a particular asset, mechanism or arrangement to meet its obligations under SLC 4B, the supplier must either own that asset, mechanism or arrangement, or have Sufficient Control over it so that it can rely on it legally and enjoy the benefit of it. For example, if a supplier uses hedging positions to procure energy on the wholesale energy markets to manage and mitigate the risks of insolvency it should either own those hedging positions, or, if those hedging positions are held by a different entity other than the supplier, the supplier should have robust, legally enforceable and clearly defined arrangements in place with the entity that owns the hedging positions that enable the supplier to rely on and enjoy the benefit of those hedging positions.

3.20. Furthermore, where a supplier uses a particular asset, mechanism or arrangement to meet its obligations under SLC 4B the supplier must not liquidate, sell or otherwise dispose of that asset, mechanism or arrangement where doing so risks an increase in Mutualised costs. For example, if a supplier uses hedging contracts to procure energy on the wholesale energy markets, it should not liquidate, sell or otherwise dispose of those hedging contracts in circumstances where doing so increases the likelihood of consequential Mutualised costs or an increase in those Mutualised costs.

3.21. Without in any way limiting a supplier's obligations under its Licence, this Guidance or otherwise, nothing in this Guidance shall restrict the ability for wholesale sellers (including commodity traders and wholesale suppliers), lenders or other finance providers (or their agents) to a supplier from enforcing, reserving or waiving their rights in accordance with the contractual terms of any hedge, wholesale supply, funding or other financing arrangement entered into with such supplier, including enforcing security over

such supplier's assets that secure such supplier's obligations to such wholesale sellers, lenders or other finance providers (or their agents) in such manner as such wholesale sellers, lenders or other finance providers (or their agents) see fit.

### **Minimum Capital Requirement and Alternative Source Conditions**

3.22. By 31 March 2025, domestic suppliers are expected to hold [XX] in Net Assets per domestic customer. Net Assets is defined as [fixed assets + current assets] – [current liabilities + long-term liabilities]. For the avoidance of any doubt, this definition is in line with the definition of Net Assets used for statutory accounting purposes. Suppliers should therefore interpret it in the same way, so the definition used for Net Assets for statutory accounting purposes should be considered the definition used for Net Assets for the purposes of the Minimum Capital Requirement. In addition to specific reporting points set out in this section from paragraph 3.36, we expect suppliers to be able to demonstrate that they hold the Minimum Capital Requirement at all times.

3.23. Suppliers should apply the same Minimum Capital Requirement across all their domestic customers and apply it equally across dual and single fuel customers – regardless of what tariff the customer is on, or the payment method used.

3.24. Where a licensee supplies both domestic and non-domestic customers, we would expect the supplier to explain in its Annual Adequacy Self-Assessment any split of assets between the supply business for non-domestic supply versus domestic supply, to help show how the Net Assets calculation for the Minimum Capital Requirement maps across the business, and if there are any implications for the impact of the measure on resilience.

3.25. Although the Minimum Capital Requirement does not apply at this stage to non-domestic supply, non-domestic suppliers are subject to all the other conditions in the FRP, and as a result are expected to ensure they maintain sufficient Capital and Liquidity for their business model and risks, as set out from paragraph 3.36.

3.26. The measure of Net Assets implies an equity-funded Minimum Capital Requirement. However, suppliers are able to hold the Minimum Capital Requirement using alternative sources of funding, to the extent the supplier can demonstrate those sources of funding provided that funding meets the Alternative Source Requirements defined in the licence which includes that the alternative funding results in a level of resilience equivalent to the Minimum Capital Requirement.



3.27. Suppliers must set out in their capitalisation plan in the Annual Adequacy Self-Assessment reporting (set out from paragraph 3.37) how they intend to meet the Minimum Capital Requirement. Ultimately, though, if a supplier chooses to use alternative sources of funding to meet the Minimum Capital Requirement, they must formally notify Ofgem 12 weeks ahead of the Minimum Capital Requirement compliance date of 31 March 2025.

3.28. In explaining its proposal for using alternative sources of funding with an equivalent impact on its resilience, such as parent company guarantees, letters of credit, credit facilities, and long-term unsecured debt, the supplier must have regard to the criteria set out in the licence, which include:

- Overall, the alternative source of funding must be sufficient to ensure that the licensee can meet any risks or liabilities that the licensee reasonably anticipates.
- Where alternative sources of funding are held by the licensee, such as debt or similar financial instruments, it must not be secured on licensee assets by a fixed or floating charge or other security arrangements.
- Where alternative sources of funding are held by a third party:
  - Suppliers must have robust, legally enforceable, and clearly defined arrangements in place to ensure that they can draw on the source of funding at all times, including in times of financial stress.
  - The third party must have, and maintain, a long-term credit rating of not less than BBB by Standard and Poor's or equivalent rating by either Moody's or Fitch Ratings.
  - Arrangements should not be capable of termination without good cause and without sufficient notice to enable the licensee to put in place arrangements to meet the Minimum Capital Requirement in an alternative way.

3.29. Where a supplier meets its funding requirements from a wholly or partially external source (e.g. a parent company), suppliers must demonstrate as part of its notification to the Authority that it has a legally enforceable undertaking from the external entity which states that the external entity will refrain from any action that would be likely to cause the licensee to breach any of its FRP obligations. This must be accompanied by evidence which demonstrates how the funding will be legally transferred to the applicant, the terms and conditions of any funding (including payment terms for loans/debt instruments) and which satisfies Ofgem that the supplier is legally and readily able to access these funds.

3.30. Below sets out some questions suppliers must consider when assessing the reliability of an external source of funding to meet the minimum requirement.

Source of funding	Considerations
On balance sheet long-term liabilities	<ul style="list-style-type: none"> <li>• Does the long-term unsecured debt benefit from a fixed or floating charge or any other additional security arrangements?</li> </ul>
Credit facility	<ul style="list-style-type: none"> <li>• Is it committed facility supported by a formal agreement?</li> <li>• What is maturity of facility?</li> <li>• Is there a minimum notice period for change to facility?</li> <li>• Are there any covenants or conditions that could lead to the facility being withdrawn/ repayment being immediately due?</li> <li>• What are the repayment conditions?</li> </ul> <p>If intercompany facility:</p> <ul style="list-style-type: none"> <li>• Does the parent company have access to sufficient funds to cover capital difference considering overall group requirements?</li> <li>• Is the parent financially stable?</li> <li>• What is the risk of the facility being overdrawn?</li> </ul>
Parent company guarantees	<ul style="list-style-type: none"> <li>• Are there any impediments to drawing on the funds available through the guarantee?</li> <li>• Is the guarantee revocable and under what notice period and conditions – e.g., is the parent required to pay the sums in the guarantee at any termination point?</li> <li>• What is the maturity of the guarantee or the notice-period for non-renewal?</li> <li>• What is the financial situation of the parent company?</li> <li>• Does the parent company have sufficient funds available taking into account other group stresses?</li> </ul>
Letters of credit	<ul style="list-style-type: none"> <li>• Is the letter of credit revocable on the part of the issuing financial institution (as long as conditions are complied with?)</li> <li>• Is the letter of credit transferable and what are the rights of the subsidiary to readily draw on it?</li> <li>• What is the bankruptcy risk of the issuing bank or financial institution and mitigations for this event?</li> <li>• Is the letter of credit a non-subordinated payment obligation of the issuing financial institution?</li> </ul>

3.31. After 31 March 2025, as with other reporting Trigger Points defined in this Guidance, suppliers will be expected to notify Ofgem as soon as reasonably practicable when they become aware that there is a Material risk that they will not hold the 2025 Minimum Capital Requirement, and as soon as reasonably practicable after it does not hold the 2025 Minimum Capital Requirement, as set out in paragraph 3.65.

3.32. As with other reporting Trigger Points, if the licensee breaches the Minimum Capital Requirement following the required date of compliance of 31 March 2025, the supplier must notify the Authority at least 28 days before making any payment, providing any loan or transferring any asset to any third party unless that payment, loan or transfer is one that is essential to the licensee’s operation as a supplier of gas and electricity to consumers.

3.33. Information provided in other Supervisory Financial Reporting, such as stress tests and regular financial monitoring, will also be used by the Authority to understand if a supplier is on a credible pathway to compliance before March 2025, or if after March 2025 they are not meeting – or at risk of not meeting – the requirement.

### **Reporting requirements**

3.34. The FRP includes requirements on suppliers to proactively report to Ofgem in relation to how they are meeting requirements for ongoing financial resilience, and to identify where risks to their financial situation arise. Below we set out further detail on expectations for that supplier reporting.

### **Annual Adequacy Self-Assessment**

3.35. To evidence their compliance with the FRP, suppliers must provide an annual self-assessment (the “Annual Adequacy Self-Assessment”), detailing the analysis that underpins their evaluation of compliance with all the FRP’s requirements, including to:

- Maintain Capital and Liquidity of sufficient amount and Quality to meet reasonably anticipated financial liabilities as they fall due.
- Meet the Minimum Capital Requirement.
- Ensure Orderly Market Exit.
- Responsibly manage costs at risk of Mutualisation.

3.36. We will notify suppliers when they need to submit reporting. We understand suppliers will have different timelines they use for financial planning. We will consider these timelines alongside the need for timely and comparable assessments when setting the reporting date.

3.37. How a supplier completes its Annual Adequacy Self-Assessment, including the evidence it provides, will vary, as we recognise there is no one-size-fits-all approach to running a supply business. However, Ofgem will have consideration for:

- Quality of reporting in terms of its accuracy and whether any assumptions underlying reporting projections, stress testing, risks and mitigations are reasonable.
- The appropriateness of the internal processes for the analysis in the report and whether they are sufficiently sophisticated considering the supplier business model and risks.
- The policies and processes a supplier has to identify, measure and manage the Material sources and effects of relevant risks in the reporting.
- Whether reporting sufficiently identifies and considers the range of risks and interactions of those risks that the business is exposed to, how those risks are likely to evolve, and whether the supplier has considered the impact of severe but plausible stress scenarios to those risks.
- Whether the supplier has sufficiently considered and made reasonable assumptions about the risks associated with its identified sources of funding to meet the FRP.
- If reporting sufficiently explains how the supplier is impacted by its association with a group or other entities within the group, or with other third parties who can impact its financial situation or the availability of Capital and Liquidity.
- The involvement of senior management in the process, and clear ownership of risks and mitigations amongst senior management.

3.38. The Annual Adequacy Self-Assessment must be accompanied by a signed declaration of financial and operational adequacy (“Certificate of Adequacy”) which has been approved by the licensee’s Chief Financial Officer, or senior official with equivalent responsibility, affirming that they have a reasonable expectation that the licensee meets the Minimum Capital Requirement or holds an equivalent as approved by Ofgem. This ensures the

supplier's directors are responsible for properly assessing the supplier's financial adequacy and compliance with the FRP.

3.39. The Annual Adequacy Self-Assessment should include an executive summary, focusing attention on distilling key messages of the drivers of performance and risk, and presenting key strategic insights regarding financial resilience. It should provide sufficient information to give Ofgem a clear view of the key drivers of business performance, including commentary on the risk appetite, and materiality of each factor.

3.40. Although we will not dictate or prescribe how suppliers should evaluate their financial adequacy and FRP compliance and how to report it, the Annual Adequacy Self-Assessment must cover:

Business-specific arrangements and risks

3.41. Suppliers should explain how they have come to a view on the appropriate level of Capital and Liquidity needed to be compliant with the FRP. This should include an evaluation and explanation of the supplier's business plan and business-specific risks over the coming 12-month period which the supplier uses to inform their Capital and Liquidity planning to remain compliant with the FRP. A non-exhaustive list of what this should consider includes:

- How the supplier is funding any regulatory obligations.
- The supplier's risk appetite associated with its business strategy, e.g. tariff pricing, hedging strategy, purchasing agreements.
- Identification and explanation of all business-specific risks, having consideration for the range of risks set out in paragraph 3.5. This includes, for example, explaining how the supplier considers less quantifiable operational risks – such as exposure to risks associated with other entities within a group.
- Explanation and evaluation of the effectiveness of associated mitigation strategies.
- Reliance on the balancing market.
- Presence and conditions of purchasing agreements, and risks and mitigations associated with those conditions.
- Collateral requirements.

- Description of internal processes for identifying and mitigating risks.
- Explanation of how supplier has subjected their business projections and risks to severe but plausible stresses consistent with their risk profile. We expect suppliers to show reasonable assumptions when discussing how they will manage potential downside risk.

3.42. The supplier should explain how this internal evaluation of their business specific arrangements and risks informs their Capital and Liquidity planning to ensure compliance with the FRP.

3.43. The supplier should explain how it intends to deal with each of the risks its business is subject to, including how it has quantified the risk into a certain amount of Capital or Liquidity to mitigate it, or other ways that it intends to mitigate the risk that warrant not holding extra Capital or Liquidity against it. Where a risk is not obviously quantifiable – e.g. certain types of operational risk – a supplier should explain mitigations, and whether it has decided to hold additional Capital or Liquidity against that risk while working towards mitigation.

3.44. The supplier should also explain the sources of funding it intends to rely on to comply with the FRP. This includes describing characteristics of on and off-balance sheet funding they intend to rely on, and how these characteristics would be impacted under severe but plausible stress scenarios the supplier’s business could be subject to. Suppliers should have consideration for the standards set out from paragraph 3.30 in relation to the Minimum Capital Requirement when describing the sources of funding it relies on.

#### Supplier capitalisation plan

3.45. The supplier must provide a plan for how it intends to meet the March 31, 2025 Minimum Capital Requirement, as set out in the FRP, within the context of its business plan and risks. For that plan to be credible, we consider that the supplier should illustrate how they will achieve at least an above-zero net asset position about a year ahead of the minimum requirement going live.

3.46. The capitalisation plan should also set out whether the supplier intends to rely on alternative sources of funding to meet the Minimum Capital Requirement. If so, the capitalisation plan should describe what alternative sources of funding the supplier anticipates on relying on, and that funding must comply with the Alternative Source

Conditions and with the criteria on alternative sources of funding set in this Guidance from paragraph 3.30.

3.47. Once a supplier meets the Minimum Capital Requirement, it will still be expected to continue reporting in its Annual Adequacy Self-Assessment how it is meeting the Minimum Capital Requirement, within the context of the supplier's broader business plan, risks, projections, and under severe but plausible stress scenarios.

3.48. Where the supplier projects that there is a Material risk that it will not meet the Minimum Capital Requirement in the next 12 months, or when it becomes aware it does not hold the Minimum Capital Requirement, it must notify Ofgem as soon as reasonably practicable as set out in paragraph 3.60.

3.49. Within the Annual Adequacy Self-Assessment, the supplier should explain in its reporting what measures it will take to mitigate the risk of dropping below the Minimum Capital Requirement as projected and describe plans how it would come back into compliance in a reasonable time frame. For the avoidance of doubt, in this situation the Authority may have the power to take compliance or enforcement action to bring the supplier into compliance.

3.50. We expect that in reporting on both their projected compliance and actual compliance with the Minimum Capital Requirement for the purpose of the Annual Adequacy Self-Assessment, suppliers must rely on the definition of Net Assets provided in SLC 4B. For the avoidance of any doubt, this definition is in line with the definition of Net Assets used for statutory accounting purposes. We expect suppliers to be tracking their Capital position throughout the year, and that they should be able to provide Ofgem with information about their Capital position versus Net Assets at any point.

3.51. Information provided in other Supervisory Financial Monitoring, such as stress tests and regular financial monitoring, will also be used by the Authority to understand if a supplier is on a credible pathway to compliance before March 2025, or if after March 2025 they are not meeting – or at risk of not meeting – the Minimum Capital Requirement.

Orderly Market Exit/ minimising Mutualisation costs/ asset control

3.52. Suppliers should set out how they have regard for the requirement to ensure financial and operational arrangements are in place to allow for an Orderly Market Exit, and it should be clear how this fits into their business, Capital and Liquidity planning.

3.53. When explaining how they comply with the requirement to ensure financial and operational arrangements allow for Orderly Market Exit and build this into their business, Capital and Liquidity planning, suppliers should explain how they have regard for asset control rules, including the requirement to ensure Sufficient Control over any Material Economic and Operational Asset, and the prohibition on liquidating, selling or disposing of Material Economic and Operational Assets it uses to meet FRP obligations where that would increase costs at risk of being Mutualised.

#### Reliance on CCBs

3.54. A supplier must have the ability to meet its financial obligations while not being overly reliant on CCBs for its working capital. Suppliers must report on their reliance on customer credit balances. As set out in paragraph 3.65, suppliers are expected to notify Ofgem when Gross CCBs net of Unbilled Consumption represent the equivalent of 50% or more of their total assets. We also expect suppliers to notify us when they project or anticipate this occurring.

3.55. In their annual reporting, suppliers should consider this threshold and whether any of their projections – including under severe but adverse stress – could have an impact on CCB reliance and the extent to which this may put them above the reporting threshold.

#### Governance and internal capability, systems, and processes

3.56. Suppliers should explain their internal capability and processes to monitor and mitigate business-specific risks, and how their governance process takes these considerations into account in business planning, and Capital and Liquidity planning.

3.57. Suppliers should also explain any internal audit capability and how this is used in making judgements about business and Capital and Liquidity planning.

3.58. Reporting should include a summary of relevant governance arrangements and processes, an explanation of core business functions (including those outsourced) and how they will be resourced. This should include statements of responsibility for each core function, the names of those responsible for each area and how they are suitable to manage those responsibilities, as well as projected growth and the number of staff forecast for each function. The reporting should also include an overview of internal audit requirements and processes.



### **Reporting triggers**

3.59. Suppliers must notify Ofgem in writing as soon as reasonably practicable after the supplier becomes aware a Trigger Point may occur, or as soon as reasonably practicable once it becomes aware a Trigger Point has occurred. The Trigger Points are not an exhaustive list of possible indicators that could imply financial deterioration – so we would expect that suppliers notify the Authority at any point where there is a Material change to any aspect of their financial position that could impact their current or future ability to be compliant with the FRP.

3.60. Trigger Points are indicators and are set at points where we may be concerned about the direction or future outcome of a supplier’s financial situation. Suppliers should consider the full context of their business model and risks, and the impact of severe but plausible stress scenarios, as well as seasonality when assessing whether a change may have a sustained or Material impact on their financial situation and ongoing ability to meet the FRP, and on the likelihood of any Trigger Point occurring.

3.61. Once notified, we will consider the Trigger Point alongside the range of information we already collect on that supplier and make an assessment on further action. We may seek further engagement, and where appropriate may agree a suitable reporting arrangement. Any additional reporting would be proportionate and assessed on a case-by-case basis. Where we have concern about a supplier’s compliance following notification, we may decide to undertake further assessment and engagement, request an independent audit, consider whether a direction to Protect its CCBs is appropriate, and/or move to consider enforcement action where appropriate.

3.62. If the licensee does not hold the Minimum Capital Requirement following the required date of compliance of 31 March 2025 or if any of the Trigger Points have occurred, the supplier must notify the Authority 28 days before making any payment, providing any loan or transferring any asset to any third party unless that payment, loan or transfer is one that is essential to the licensee’s operation as a supplier of gas and electricity to consumers.

3.63. Where Ofgem assesses it is requisite to secure compliance with the FRP or other obligations, Ofgem may restrict the supplier from extracting value from the business as appropriate, using our enforcement powers. If Ofgem does not respond within the 28 days ahead of the scheduled transaction, and in the absence of such restrictions, the supplier can proceed with the transaction as planned.

3.64. Trigger Points are:

- **Material changes in access to funds:** Suppliers must notify Ofgem of projected or actual Material changes to access to funds. This includes, but is not limited to, where suppliers identify scenarios where they may no longer have access to funds from an investor/parent company/bank/lenders, or if funds or borrowings have been, or will be, reduced.
- **Changes in profit/revenue/Liquidity:** Suppliers must notify Ofgem where there are Material changes to profit and/or levels that impact their ability to meet their liabilities as they fall due, and where they anticipate a drop in revenue over a certain period will lead to sustained losses, potential breach of debts or financial covenants.
- **Change and/or potential failure of counterparties:** Suppliers must notify Ofgem where a likely failure of a counterparty may have a Material impact on their ability to meet their liabilities as they fall due. When making this assessment, suppliers should consider:
  - changes in the creditworthiness or the default of a counterparty, which may result in direct losses for the supplier or the need to revalue or replace transactions.
  - changes in market conditions which may result in the supplier incurring greater costs to replace a transaction that the counterparty has failed to settle.
  - the risk that collateral received from the counterparty may not be as effective as expected at covering the losses arising from that counterparty's failure or default.
- **Changes to hedging position:** Suppliers should notify Ofgem where changes to their hedging position may have a Material or sustained impact on whether a supplier can continue to meet its obligations under the FRP.
- **Changes in Net Assets/net liabilities:** Suppliers should notify Ofgem where they anticipate Material changes to their Net Assets and/or net liabilities may have a Material impact on the suppliers' ability to meet the FRP, including loans, dividends, and value redistribution within a group.

- **Reliance on customer credit balances:** Suppliers must notify when Gross CCBs net of Unbilled Consumption represent the equivalent of 50% or more of their total assets, and as soon as reasonably practicable when they become aware there is a Material risk of this occurring.

Where a licensee supplies to both domestic and non-domestic customers, they must explain in their Trigger Point notification under SLC 4B.12 as well as their Annual Adequacy Self-Assessment (as set out from paragraph 3.37 in this Guidance) how they split assets between their domestic and non-domestic supply. This will help us understand the implications of the supplier's Trigger Point notification and to make an assessment on the appropriate response.

We will continue to review the CCB notification threshold number to ensure it can achieve the intended outcome of encouraging suppliers to avoid overreliance on CCBs, and therefore this number may be subject to change. The process by which this Guidance may be amended is set out in the introduction.

- **Meeting the Minimum Capital Requirement following 31 March 2025:** Following the date of required compliance with the Minimum Capital Requirement of 31 March 2025, suppliers are required to notify Ofgem when they become aware of a Material risk which means they may not meet the Minimum Capital Requirement, or as soon as reasonably practicable when they no longer comply with it.

### **Financial monitoring**

3.65. In addition to supplier self-assessments, Ofgem also collects reporting through Supervisory Financial Monitoring. This includes stress testing, which Ofgem intends to carry out on a regular basis, as well as regular financial monitoring.

3.66. To ensure that the information we are asking for is as relevant as possible and can adapt to changing market conditions, the specific nature of the stress tests or information requests will be specified at each reporting juncture.

3.67. In the case of stress testing, Ofgem expects to send the supplier a notice setting what information they will be asked to provide a minimum of four weeks ahead of the reporting deadline. Suppliers should make sure that the board is satisfied that the stress tests have been prepared with due care and skill.

3.68. For more regular financial reporting, suppliers are provided a timetable in advance. If there are changes to the questions, suppliers will generally be given notice a minimum of

two weeks before the reporting deadline. These timings could be shorter in the case where Ofgem identifies a sudden and urgent need to change reporting requirements in line with our ability to request information from suppliers as part of SLC 5.

3.69. Suppliers must respond in full to any information requests made under SLC 5 or using other information gathering powers, in the timeframe and form set out in the information request. If they are unable to respond to a specific question, they should provide a clear explanation in writing why. Where a supplier does not respond in full or on time or where we consider that the response evidences a contravention or likely contravention (or apparent contravention or likely contravention), we may consider taking appropriate enforcement action.

#### How different sources of financial resilience reporting are used

3.70. We will consider, on a cumulative basis, a range of Supervisory Financial Monitoring, such as Market Compliance Reviews<sup>10</sup> and Milestone Assessments<sup>11</sup> (where relevant) to complement supplier self-assessment reporting and enhanced financial monitoring under SLC 4B.13 to inform our position on a supplier's resilience. This integrated picture of supplier resilience will underpin our assessment and decision on how to respond.

3.71. As highlighted above, we appreciate that there will not be a one-size-fits-all approach to how a supplier should run its business. However, where we see poor practice and potential risk, we would look to use our powers to intervene to protect consumers and reduce potential cost Mutualisation for the rest of the GB energy market.

3.72. If we have concerns regarding the arrangements a supplier has in place, we may seek further engagement, and if appropriate may agree a suitable reporting arrangement, noting suppliers' obligation to be open and cooperative when providing us with information. Any additional reporting would be proportionate to the risk of Mutualisation and assessed on a case-by-case basis. Where we have concerns about a supplier's compliance with these principles, we may decide to request and set the terms of reference of an external audit, request information, as well as conduct 'fit and proper' assessments for individuals with 'significant managerial responsibility or influence' as required under SLC 4C of the gas and

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<sup>10</sup> These are where the Authority gathers and analyses information from licensees regarding their compliance with particular obligations. Following this analysis, the Authority may publish its findings and the degree of compliance achieved by individual suppliers.

<sup>11</sup> Under Standard Licence Condition 28C

electricity supply licences. The outcomes of the range of supplier reporting will inform our assessment and decision on whether to direct a supplier to ringfence customer credit balances (see the section on Directing the Protection of Domestic Customer Credit Balances below). We may also move immediately to consider whether enforcement action is appropriate.

3.73. A supplier's financial circumstances will fluctuate over time. To adhere to the Financial Responsibility Principle, we expect all licensees to be open and transparent with us on an ongoing basis. We expect that suppliers should also regularly review and update their finance and growth plans and have set out the circumstances under which we expect suppliers to notify us as part of the Trigger Point reporting process. However, we also expect to be notified where suppliers identify current or potential future financial difficulties that are not included in the list of identified Trigger Points. We strongly encourage suppliers to engage with us early.<sup>12</sup>

3.74. Our enforcement guidelines set out the approach we take to enforcing against all licence conditions, including the Financial Responsibility Principle.

### **Directing the Protection of Domestic Customer Credit Balances**

3.75. The following paragraphs explain:

- When the Authority may issue a direction to ringfence a proportion of a supplier's CCB.
- What a CCB ringfencing direction, if made, will require a supplier to do and how that will be determined.
- The process to be followed once a CCB ringfencing direction has been made to set up appropriate Credit Balance Support Arrangements and reporting processes.

#### When a direction of CCB ringfencing may be made

3.76. Where the Supervisory Financial Monitoring data (as described from paragraph 3.67) or any data or information Ofgem receives indicates that a licensee is not meeting or is at a Material risk within the next 12-month period of not meeting the standards in the FRP, this

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<sup>12</sup> In accordance with our open and co-operative principle (SLC 5A) we would expect a financially responsible supplier to seek early engagement with us to communicate, and reassure us of, significant changes to its financial position or its approach to financial management

may lead to a range of interventions, including the possibility of directing CCB ringfencing. These standards are listed below:

- (4B.1) The licensee must ensure that it maintains Capital and Liquidity of sufficient amount and Quality that it is able to meet its reasonably anticipated financial liabilities as they fall due on an ongoing basis.
- (4B.2) The licensee must ensure that, were it to exit the supply market (due to insolvency, licence revocation or in any other circumstances), said exit would be an Orderly Market Exit.
- (4B.3) The licensee shall at all times manage responsibly costs that could be Mutualised and take appropriate action to minimise such costs.
- (4B.4) If the licensee supplies to Domestic Premises, with effect from 31 March 2025, the licensee must, at all times, maintain the 2025 Minimum Capital Requirement.
- (4B.5) Where the licensee uses a Material Economic and Operational Asset to meet any of its obligations under this condition, the licensee must have Sufficient Control over it.
- (4B.6) The licensee shall not liquidate, sell or otherwise dispose of Material Economic and Operational Assets it uses to meet any of its obligations under this condition, if doing so risks an increase in costs at risk of being Mutualised.

3.77. Note, however, that in relation to the standards at SLCs 4B.3 and 4B.6, these interventions, including the direction of CCB ringfencing, can only be made:

- In relation to SLC 4B.3, circumstances when Gross CCBs net of Unbilled Consumption represent the equivalent of 50% or more of a supplier's total assets.
- In relation to SLC 4B.6, in circumstances where the licensee liquidates, sells or otherwise disposes of Material Economic and Operational Assets it uses to meet any of its obligations under this condition, if doing so risks a Material increase in costs at risk of being Mutualised.

3.78. Any direction issued will detail the grounds on which the direction has been issued, pursuant to 4B.10.

3.79. If Ofgem directs a supplier to ringfence their CCBs, it is not intended this would impact their amount of Net Assets for the purpose of the Minimum Capital Requirement.

What a CCB ringfencing direction requires the supplier to do

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3.80. Where Ofgem decides to issue a direction, the licensee will be required to Protect a proportion of its CCBs in accordance with the methodology and process set out at SLC 4D (see below). This means that the licensee will establish, through a range of available mechanisms, arrangements that ensure that the Protected Amount will not be Mutualised and is available to be passed to the SoLR in the event of failure of the licensee.

3.81. The licensee can choose from a menu of mechanisms to establish the required Credit Balance Support Arrangements, including:

- Standby Letter of Credit
- First Demand Guarantee
- Escrow account
- Cash deposited in a Credit Balance Trust Account

3.82. More than one mechanism can be utilised, depending on the circumstances and structure of the licensee.

#### The Adjustment Percentage

3.83. To determine the amount to be Protected under a CCB ringfencing direction, Ofgem will provide the supplier with an Adjustment Percentage that the supplier must apply to its CCBs. The Adjustment Percentage will be between 0% and 100%. This will be determined on a case-by-case basis as described below.

3.84. The Adjustment Percentage will be determined by an assessment of Supervisory Financial Monitoring data and any proposed Adjustment Percentage will be tested against Consumer Interest. Ofgem will direct an Adjustment Percentage which, at the point of issuance, will not have an adverse effect on the licensee's ability to finance its activities to the extent that the level of the Adjustment Percentage is likely to cause the licensee to exit the market due to insolvency. Ofgem will also direct an Adjustment Percentage which, in the event that the licensee was to exit the market nevertheless or have its licence revoked, means that, as far as possible any potential Mutualised costs would be minimised.

#### Consumer Interest

3.85. If CCB ringfencing is directed, Ofgem will consider Consumer Interests when determining the level of the Adjustment Percentage that the licensee must apply. Consumer Interest is the likely impact of any adjustments on Resilience, Prices, Quality and Standards and Low-Cost Transition to Net Zero.

- Resilience considers the impact of any adjustment on the proportion of the market at risk of failure and the likely Mutualised cost that would result.
- Prices means the impact of any adjustment on charges for the supply of electricity and / or gas.
- Quality and Standards relates to the impact of any adjustment on the level of competition, innovation and customer service in the market.
- Low-Cost Transition to Net Zero considers the impact of any adjustment on the ability of licence holders to progress towards an energy system which relies on renewable zero-emission sources and facilitates the use of zero-emission technologies.

#### Calculation of Protected Amount

3.86. The licensee will calculate the Protected Amount in accordance with SLC 4D.4 based on Gross Credit Balances in relation to fixed Direct Debit domestic customers minus the Unbilled Consumption of all fixed Direct Debit domestic customers, multiplied by the Adjustment Percentage. The balances of other customer groups including pre-payment customers, those paying on demand, by variable Direct Debit, or by other methods are not required to be included in the calculation.

#### Notice of a proposed direction and making representation

3.87. Prior to directing a licensee to ringfence CCBs Ofgem will issue a notice of intent to direct. The licensee will have a period of no less than 7 days from the date of the notice during which the licensee can make a representation to Ofgem. The time permitted for representation will be stated in the notice along with details on how to make the representation. Ofgem will review the representation, contacting the licensee if additional information is required. Following a review of the representation Ofgem will decide whether to issue a direction.

#### Timetable for ringfencing CCBs following a direction

3.88. Once a direction to ringfence CCBs takes effect, the licensee will be required to calculate the Protected Amount using data from close of business on the date specified in the direction. This will usually be the day after the direction takes effect. This means that the duration of the Credit Balance Support Arrangements for the Initial Period may be



longer than a calendar month. For each full calendar month following the Initial Period, the calculation of the Protected Amount will be based on data as at close of business on the last day of the previous calendar month (see below for a worked-out example).

3.89. The schedules for implementing ringfencing of CCBs for the Initial Period and each subsequent calendar month are shown in Figure 1 (Timetable for implementation and ongoing Protected Amount calculation). The schedule is based on calendar days and so weekend days are counted.

3.90. Between Day 14 (when the calculation of the Protected Amount and supporting details are submitted) and the day that the Credit Balance Support Arrangements go live, Ofgem will review the calculation and protection arrangements submitted by the licensee. If, in the opinion of Ofgem, the calculation and / or the protection arrangements fail to meet the requirements of the direction, the licensee must take remedial action to ensure the requirements are fully met. Any remedial revisions to the calculation and / or protection arrangements must be approved in writing by Ofgem before the deadline for the Credit Balance Support Arrangements takes effect (Day 28 for the Initial Period or the first day of the calendar month, as appropriate). A submission will fail to meet the requirements of the direction if:

- The calculation is inaccurate
- The protection arrangements fail to meet the requirements of SLC 4D
- The protection arrangements are not provided in the agreed form [link to the templates]
- The submission contains inaccurate or incomplete information

Figure 1. Timetable for implementation and ongoing Protected Amount calculation:

Relevant Period	Initial Period	Subsequent calendar month
Direction takes effect	Day 1	NA
Calculation data from close of business	Day 2	Last day of the previous calendar month
Support arrangements & calculation submitted to the Authority	Day 14	Day 14 of month
Credit Balance Support arrangements go live	Day 28	Day 1 of following calendar month

Example scenario for an initial cycle:

- 10th January direction takes effect (Day 1)

- 11th January – Data from close of business to be used to undertake calculation (Day 2).
- 23rd January – Calculation and protection arrangements submitted to Ofgem (Day 14).
- 23rd January to 5th February – any issues with the submission to be rectified.
- 6th February – protection arrangements take effect, in respect of calculation data from 11th January (Day 28).

Example scenario for a subsequent calendar month cycle:

- 28th February – Data from close of business on the final day of the calendar month to be used to undertake next calculation.
- 14th March – Calculation and protection arrangements submitted to the Authority, (in respect of the calculation data from 28th February).
- 14th March to 31st March – any issues with the submission to be rectified, in respect of the calculation data from 28th February.
- 31st March – Data from close of business to be used to undertake calculation for next protection period.
- 1st April – protection arrangements take effect, in respect of the calculation data from 28th February.

Where the following dates fall on a weekend or public holiday the due date will be the next working day:

- Representation closure date
- Submission date
- Protection arrangements live date

Templates for use when establishing Credit Balance Support Arrangements

3.91. In order to reduce costs and simplify the process of establishing Credit Balance Support Arrangements, Ofgem has provided templates which must be used to make the contractual arrangements for licensees' chosen Credit Balance Support Arrangements. These templates reflect the conditions contained in 4D and are published separately in an annex to this Guidance. The templates contained in that annex will cover:

- First Demand Guarantee
- Standby letter of credit
- Trust account
- Escrow account

3.92. Each time a new Credit Balance Support Arrangement is required the template must be downloaded from the Authority's website. This will ensure that the current version of the template is being used.

3.93. No changes are permitted to the template.

3.94. All fields should be completed in full.

3.95. Note: The same template versions are used for securing Credit Balance Support Arrangements for the ringfencing of CCBs, in accordance with SLC 4D, and RO Credit Cover Mechanism(s) in accordance with SLC 30.

#### Credit Balance Support Arrangements reporting requirements

3.96. By Day 14 of each calendar month (following the Initial Period) the licensee must submit evidence of their calculation and Credit Balance Support Arrangements in accordance with the requirements of SLC 4D and the direction. Each submission should contain the following:

- Calculation of funds to be protected, including supporting information, data and any analysis used to make the calculation.
- Evidence that the licensee's Credit Balance Support Arrangements cover the most recently calculated Protected Amount, including (where applicable) the most recent bank statement in relation to any Credit Balance Trust Account or Credit Balance Escrow Account and copies of its Credit Balance Support Arrangements (template).
- Written confirmation from a director that the calculation and Credit Balance Support Arrangements are compliant with SLC 4D.

#### Revocation of direction

3.97. When the Authority is satisfied that the licensee is able to meet its financial resilience obligations or when there is no longer a Material risk that the licensee will fail to meet the required financial resilience standards SLC 4B.1 to 4B.6 within the next 12-month period (as appropriate) the Authority will revoke the direction.

3.98. Any revocation will be subject to consultation with the licensee. Once a revocation notice is issued the licensee is no longer required to comply with the direction, although the licensee may opt to continue to Protect CCBs on a voluntary basis.



