

Strengthening Financial Resilience

Investor Relations Call



OFG1161

5th April 2023

Welcome

Welcome and introductions – *Steven Alcorn*

14:00 - 14:05

Decision & Statutory Consultation

Overview of Announcements – *Rohan Churm*

14:05 - 14:20

Decision on Strengthening Financial Resilience – *David Hall*

Statutory Consultation on Capital Adequacy and Ringfencing CCBs – *David Hall*

Next Steps – *Rohan Churm*

Q&A

Q&A – *Steven Alcorn*

14:20 - 14:40

Close

Close – *Rohan Churm*

14:40 – 14:45

Ofgem is committed to developing a retail market that is more **attractive for innovation and investment**.

Our Financial Resilience and Control measures form part of a broader programme of work to **deliver stability** to the market and ensure the financial stability of suppliers.

Two key decisions have been announced today following the consultation in November:

- Introduction of an *Enhanced Financial Responsibility Principle* and monitoring framework
- *Ringfencing of Renewables Obligation (RO) receipts*

We have also published a **further statutory consultation** on two elements of the package:

- Common *minimum capital requirement*
- The power to direct *ringfencing of customer credit balances*

- The **Enhanced Financial Responsibility Principle (FRP)** clarifies the financial resilience requirements for suppliers
- Should change the culture of risk reporting by suppliers:
 - **More proactive** and determined by **business-specific risks**
 - **Focused on remedies**
- More onus on suppliers to ensure they can meet their anticipated liabilities
- Establishes further monitoring tools
- Applies to domestic and non-domestic suppliers, existing and new entrants
- Effective in licenses from **31st May 2023**

- Suppliers will be required to ringfence their Renewables Obligation (RO) receipts attributable to domestic supply, as consulted upon in November 2022
- New price cap allowance reflects efficient costs of protections
- Clarifications made since consultation:
 - **Timing:** 1st compliance milestone in November 2023 covering Q1/Q2 2023/24 scheme
 - **Minimum credit rating:** require BBB-/Baa3 for parent company guarantees and A-/A3 for SBLCs
 - **Enhanced monitoring period:** suppliers will need to evidence preparations for meeting requirements ahead of November milestone
 - **Removed escrow as an option:** concerned about insolvency remoteness

1

Common Minimum Capital Requirement compliance framework

We are proposing a compliance framework which recognises the need for **flexibility given specific business needs and external economic factors**

This will be formed by the following requirements:

- Setting a **Capital Floor** from the end of March 2025 of at least zero (£0) Adjusted Net Assets per domestic gas and electricity customer
- Setting a **Capital Target** equivalent to £130 per dual fuel customer from end of March 2025
- We have undertaken further analysis to refine our views of the required level of capitalisation building on our previously proposed range of £110-220 per customer.

Common Minimum Capital Requirement compliance framework

The first Annual Adequacy Self-Assessment will require suppliers to submit a plan of how they intend to meet the Capital Target and Capital Floor in 2025

Minimum capital requirement Compliance framework



A **licence breach**, meaning that Ofgem could take enforcement action, e.g. imposing a Provisional Order.

Suppliers will be subject to the below **Transition Controls**:

- sales ban
- ban on dividends/non-essential payments

Normal monitoring of supplier through stress testing, monitoring and information requests, Annual Adequacy Self-assessment, Trigger Points.

They will be required to submit a **Capitalisation Plan** and *may* also be subject to

- Ringfencing some/all CCB
- Additional monitoring/audit

Equivalent Adjusted Net Assets per domestic dual fuel customer:

<£0

≥£0 , <£130

≥ £130

2 Definition of Capital to meet the requirement

Following the feedback from our November consultation we are proposing an **Adjusted Net Assets measure** for the minimum capital requirement, which will meet the twin objective of ensuring companies hold **loss absorbing capital** and that shareholders retain **skin in the game**.

- Adjustments to Net Assets could come in the form of Alternative Sources of Capital that may be permitted subject to Ofgem's approval and the conditions noted below:
 - **Unsecured shareholder loans,**
 - **Drawn and undrawn parent / group company working capital facilities**
 - **Unconditional corporate guarantees**

3 Ringfencing of Customer Credit Balances

We continue to believe that it is in **consumers' best interests** that individual suppliers are required to ringfence their Customer Credit Balances (CCBs) in certain circumstances.

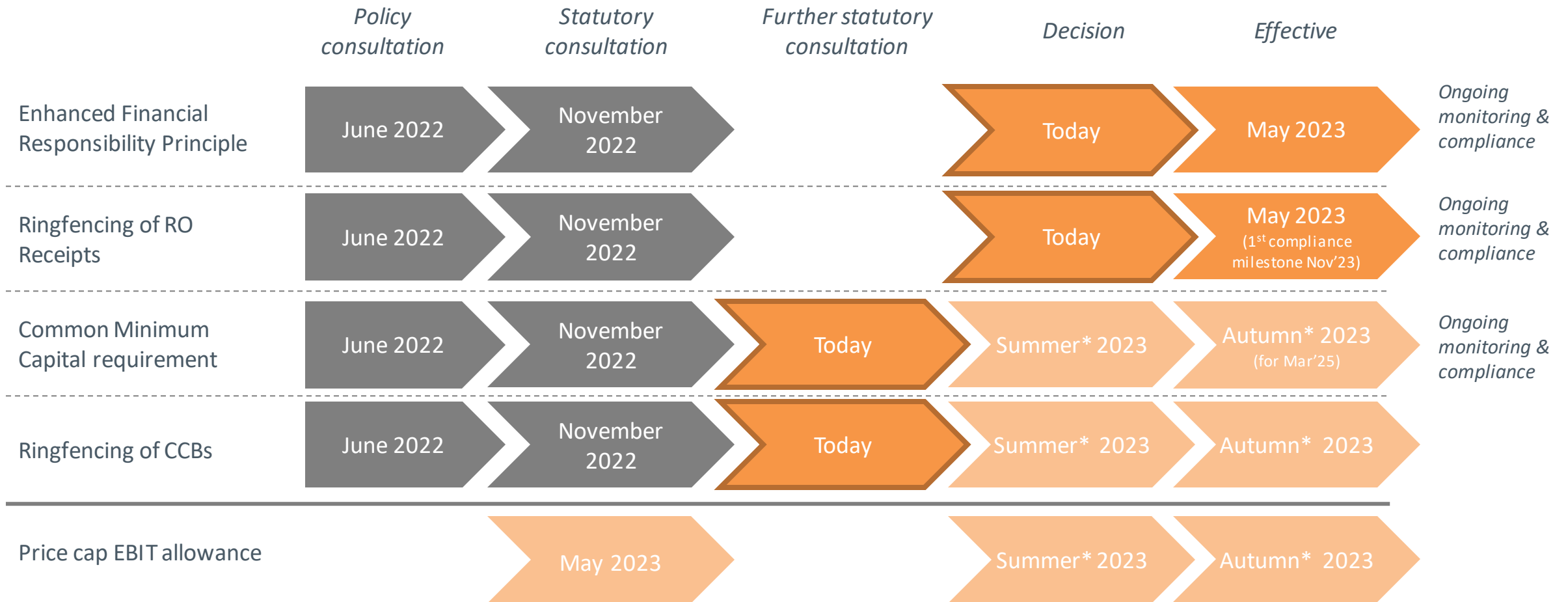
- We propose to use these powers when in specific circumstances and would direct the supplier in question to ringfence a portion of their CCBs.

This further **consultation** seeks views on our proposals for what those circumstances should be, and how the amount to be ringfenced should be determined.

If we consider it to be in the interest of consumers, we are proposing to ringfencing some – or all of - CCBs:

1. Where a domestic supplier is below the **Capital Target** from March 2025
2. Where a domestic supplier does not have **Cash** (in the bank) equal to or greater than 20% of their gross CCBs net of unbilled consumption owed to their fixed Direct Debit customers.

FRC Workstream Indicative Timetable



Note: * Subject to consultation responses

Steven Alcorn to Chair

- To ask a question, please use the hand raise function.
- **If you are joining via phone, please type *5 on your keypad to raise your hand.**
- When it is your turn, your microphone will be activated. You will need to unmute yourself.
- **Please type *6 on your keypad to unmute yourself.**
- Before asking question, please say your name and your institution.