

## Guidance on the Operational Capability and Financial Responsibility Principles

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This document provides licensees with 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.

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## 1. Introduction

1.1 The Operational Capability Principle (SLC 4A) obligates a licensee 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 licensees to take action to ensure that:

- They maintain Capital and Liquidity of sufficient amount and Quality so that they can meet their reasonably anticipated financial liabilities as they fall due on an ongoing basis;
- If they were to exit the market, that their operational and financial arrangements are such that any Supplier of Last Resort (SoLR) or special administrator appointed would be able to efficiently and effectively serve its customers and that any exit would result in minimised Mutualised costs;
- They responsibly manage costs that could be Mutualised and take appropriate action to minimise such costs at all times;
- They have adequate financial arrangements in place to meet their costs at risk of being Mutualised at all times;
- They maintain Sufficient Control over any Material and Economic Asset used to meet their obligations under SLC 4B;
- They do not dispose of said assets if doing so risks an increase in costs at risk of being Mutualised;
- From 31 March 2025 onwards, their Adjusted Net Assets do not fall below the Capital Floor;
- From 31 March 2025 they should meet the Capital Target or have a Capitalisation Plan in place that sets out how they will meet the Capital Target (that is, when in the 'Intermediate Position');
- They notify the Authority before making certain Non-essential Payments to third parties where Trigger Points occur or where a licensee is in the Intermediate Position; and
- They Protect Domestic Customer Credit Balances (CCBs) in accordance with SLC 4D, when direct.

1.2 While certain elements of SLC 4A, 4B and 4D apply only to domestic licensees, this Guidance is relevant for all domestic and non-domestic licensees.

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

### **What is the Operational Capability Principle?**

- 1.4 The aim of the Operational Capability Principle (OCP) is to ensure that licensees have the appropriate systems and processes to provide a quality service to their customers and meet their regulatory obligations.
- 1.5 It is a broad requirement on licensees to ensure that they have and maintain robust capabilities, systems and processes to enable them to serve customers effectively and have the capability to meet all relevant legislative and regulatory obligations. We are providing additional Guidance on how licensees 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 licensees 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 as part of the policy development we did in response to feedback on our consultation on Strengthening Financial Resilience.

### **What is the Financial Responsibility Principle?**

- 1.6 The Financial Responsibility Principle (FRP) acts as an overarching obligation to ensure licensees act in a financially responsible manner that is appropriate for their business specific risks. This means they properly manage risk, are well-capitalised, and able to withstand severe but plausible financial stress. As well as managing business specific risk, and proactively reporting risks to the Authority, the Principle requires that domestic licensees meet a common minimum capital requirement, comprised of the Capital Floor and Capital Target, and allows Ofgem regulatory powers to take compliance and enforcement action where we see irresponsible financial behaviour in the market.
- 1.7 To strengthen the financial resilience of the retail energy sector, we want licensees to bear an appropriate share of risk. This includes not being below the Capital Floor and achieving, or being on a path to achieve, the Capital Target, as well as adopting responsible financial management approaches. This includes holding sufficient Capital and Liquidity to meet reasonably anticipated liabilities as they fall due such that they are resilient enough to withstand future shocks, and to minimise the extent of cost Mutualisation in the event of their failure.
- 1.8 Licensees 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 licensee costs are at risk of being Mutualised upon failure if they are not managed responsibly while the licensee is trading. Customer Credit Balances, network charges and environmental and social scheme obligations are examples of this type of cost. 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 licensees do not rely on such unsustainable business models.

- 1.9 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 licensees and investors can have confidence in the energy supply market going forward.

## 2. Implementation

### 2.1 Timeline of recent modifications and go-live dates for the Financial Responsibility Principle (FRP) and the Operational Capability Principle (OCP):

Modification	Date of modification	Go-live date
FRP and OCP modified to require that licensees must have sufficient control of their material and economic assets	26 August 2022	21 October 2022
FRP modified to implement proposals from our Strengthening Financial Resilience Consultation, including Trigger Point framework and Annual Adequacy Self-Assessment, and requirement to have sufficient Capital and Liquidity for business specific risks.	5 April 2023	1 June 2023
FRP modified to implement the minimum capital requirement (by March 2025) and power to direct CCB ringfencing	26 July 2023	20 September 2023

2.2 Ofgem<sup>1</sup> previously issued guidance under SLC 4B in May 2022 and subsequently updated this Guidance again in April 2023. This new Guidance supersedes any Guidance previously issued under SLC 4B and is issued to assist stakeholders in understanding and complying with these licence conditions. We will consult on any amendments to the guidance in line with our usual public law duties and having regard to our consultation policy<sup>2</sup>. We remind all licensees that this Guidance does not modify or replace the conditions in the gas and electricity supply licences. Licensees 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>1</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.

<sup>2</sup> [Ofgem's consultation policy | Ofgem](#)

- 2.3 In accordance with its powers under the licence, the Authority may amend this Guidance. We have included from paragraph 4.17 of this Guidance, template details for the information required under SLC 4D.8 for Credit Balance Support Arrangements.
- 2.4 Taken together, the FRP licence conditions and this Guidance set out Ofgem’s emerging framework for monitoring licensee financial resilience and taking appropriate action where necessary to mitigate risks and protect consumers. As it is a new framework, we expect to iterate this Guidance in future based on feedback from licensees on the implementation of the framework and our consideration of the consumer interest.



### 3. Expectation of licensees

#### Guidance on the Operational Capability Principle

- 3.1 The objective of SLC 4A is to ensure that a licensee 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 To achieve this, SLC 4A requires 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, including but not limited to premises, facilities, staff, equipment, IT system and brand name, etc 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 either own 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. Licensees 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 licensees – 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. Licensees are required to hold Capital and Liquidity of sufficient amount. However, there is no requirement to “double count” – the sufficiency of the amount and Quality of Capital maintained for the purposes of SLC 4B.1 will be considered, among other things, by reference to the Liquidity maintained by the licensee. We would also consider the question of whether a licensee holds sufficient Capital and Liquidity against the licensee’s particular circumstances (i.e. its business model, the risks

associated with that business model and the potential impact of those risks on consumers).

- 3.5 In considering whether Capital and Liquidity are of sufficient Quality we will consider whether a licensee would be able to meet its reasonably anticipated financial liabilities as they fall due in times of plausible financial stress. This requirement applies at all times on an ongoing basis but only to reasonably anticipated financial liabilities – this is not intended as an obligation on licensees to ensure that they can absorb losses on an indefinite basis. The Capital Floor and Capital Target represent common minimum requirements and are not intended to cover all the risks that a firm could choose to take. It is therefore the responsibility of a licensee 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 and in light of its specific business strategy and risks.
- 3.6 A licensee 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 licensee 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 licensee 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 licensees purchase energy for delivery on future dates on pre-agreed pricing terms, protecting the licensee from the volatility of price fluctuations on the cost of wholesale gas and electricity. Conversely, where licensees 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 for energy rise. Licensees 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 licensees 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 licensee 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 licensee may have to re-hedge – potentially at higher prices. This may have particular risks if, for example, a licensee relies heavily on an external trading arm to procure supply and hedges, and that trading arm fails. Or, in the event a licensee 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 licensees 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 licensees 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. Licensees 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. Licensees 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.

3.7 The licensee 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 licensee

- should consider the best mitigation, and whether holding additional Capital or Liquidity could be an appropriate response until the risk is eliminated or reduced.
- 3.8 The licensee needs to consider the Quality of financial resources it has available to meet liabilities as they fall due. What this means is that the licensee 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.
- 3.9 The licensee 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. For example, to the extent any of the sources of funding it anticipates having available to cover risks are not already drawn liabilities of the licensee, and rely on the parent or another entity within the group, the licensee should ensure there are no 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 licensee itself. The licensee should also consider the impact of internal capital distribution in terms of any resources being ringfenced in the event of insolvency. We have permitted licensees to meet the common minimum capital requirement using sources of capital that we believe have acceptable risk for the purposes of the common minimum capital requirement (i.e., truly loss-absorbing in the event of a market shock) and also will not unduly increase the risk faced by consumers (see paragraph 3.36 for a list of these Alternative Sources of Capital).
- 3.10 Licensees are required to report on their financial and operational adequacy, including their compliance with the Capital Floor and Capital Target, annually (the Annual Adequacy Self-Assessment, as set out in SLC 4B.11 and paragraphs 3.51-3.76 of this guidance). Licensees should also be aware on an ongoing basis of their Capital and Liquidity position against their risks and be able to demonstrate compliance with the FRP and Capital Floor and Capital Target at any time. Whenever there is a material change to the licensee's business, the licensee is expected to 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 licensee's activities. For example, as a licensee plans to grow or introduce 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>3</sup>, stress tests and other financial monitoring and Milestone Assessments<sup>4</sup> (where relevant) to complement the Annual Adequacy Self-Assessment and triggers framework to inform our position on licensee resilience. This integrated picture of a licensee’s resilience will underpin our assessment of a licensee’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, as well as using other pieces of evidence, it will consider a range of considerations regarding the licensee’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 licensee business model and risks.
  - The policies and processes a licensee has to identify, measure and manage the Material sources and effects of relevant risks.
  - Whether the licensee 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 licensee has considered the impact of severe but plausible stress scenarios on those risks.
  - Whether the licensee has sufficiently considered and made reasonable assumptions about the risks associated with its identified sources of funding to meet the FRP.
  - Whether the licensee 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.

### **Exiting the market, cost Mutualisation and asset control**

- 3.13 Under the FRP, licensees are required to ensure that should they exit the market, their financial and operational arrangements are such that any Supplier of Last Resort (SoLR) or special administrator appointed on the licensee’s exit would be able to serve its customers efficiently and effectively and that the exit would result in

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<sup>3</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 licensees.

<sup>4</sup> Under Standard Licence Obligations 28C

minimised Mutualised costs. There is no requirement that licensees are solvent at the point of exit but we do expect licensees to minimise the costs occasioned by their exit in line with this licence condition and other regulatory obligations.

- 3.14 We would expect licensees therefore to have sufficient systems and controls in place to identify, monitor and, where practicable, reduce potential harms that could result from the licensee'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 licensee should consider whether they need to hold additional Capital or Liquidity to help mitigate those harms.
- 3.15 Closely connected to this is the obligation on licensees to responsibly manage costs that could be Mutualised and to take appropriate action to minimise such costs.
- 3.16 To meet SLC 4B.3 and/or 4B.4, we would expect a licensee to have the ability to meet its financial obligations while not being overly reliant on Customer Credit Balances (CCBs) for its working capital. We expect a licensee 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 sufficient cash in the bank to refund CCBs – licensees must notify Ofgem if they are below the Cash Coverage Trigger i.e. where their cash in the bank is less than 20% of the value of their Gross CCBs from Fixed Direct Debit customers' Net of Unbilled Consumption. This notification requirement will help Ofgem monitor when licensees do not have sufficient cash to refund CCBs.
  - 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 licensee's business so that it is predominantly reliant on investor capital and does not put at risk the Credit Balance Amount. In any event, licensees 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, being above the Capital Floor and meeting, or building up to meet, the Capital Target.
- 3.17 Without prejudice to the generality of the meaning and application of SLC 4B, we would expect a licensee 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>5</sup>
- Effective processes, that are consistent with existing licence requirements,<sup>6</sup> for example for setting direct debit levels and for checking and returning customer credit balances.<sup>7</sup>
- 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 may require evidence to show that licensees can finance their overall business plans.
- Robust financial governance and decision-making frameworks in place.

3.18 As set out in the licence, where a licensee uses a particular asset, mechanism or arrangement to meet its obligations under SLC 4B, the licensee 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 licensee 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 licensee, the licensee should have robust, legally enforceable and clearly defined arrangements in place with the entity that owns the hedging positions that enable the licensee to rely on and enjoy the benefit of those hedging positions.

3.19 Furthermore, where a licensee uses a particular asset, mechanism or arrangement to meet its obligations under SLC 4B, the licensee must not liquidate, sell or otherwise dispose of that asset, mechanism or arrangement where doing so risks an increase in costs at risk of being Mutualised. For example, if a licensee 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 risks an increase in costs at risk of being Mutualised.

3.20 Without in any way limiting a licensee's obligations under its Licence, or otherwise, nothing in this Guidance shall restrict the ability for wholesale sellers (including commodity traders and wholesale licensees), lenders or other finance providers (or

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<sup>5</sup> The Financial Responsibility Principle covers both costs that could be Mutualised following licensee 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 licensee has failed

<sup>6</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>7</sup> Under Standard Licence Obligations 27.15 and 27.16.

their agents) to a licensee 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 licensee, including enforcing security over such licensee's assets that secure such licensee'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.

### **Common minimum capital requirement**

#### Capital Floor

- 3.21 As set out in SLC 4B.16, from 31 March 2025, domestic licensees must not be below the Capital Floor at any time. Licensees set out how they are meeting the Capital Floor in their Annual Adequacy Self-Assessment. However, we expect licensees to be able to demonstrate on an ongoing basis that they are not in breach of the Capital Floor. This means licensee must not fall below the Capital Floor at any point, otherwise it is in breach of SLC 4B and Ofgem can take enforcement action.
- 3.22 As with other reporting Trigger Points defined in this Guidance, and as set out in SLC 4B.17, licensees must, with effect from 31 March 2025, notify Ofgem in writing as soon as reasonably practicable, and not more than seven days, after it becomes aware that its Adjusted Net Assets are below the Capital Floor or there is a Material risk that its Adjusted Net Assets will be below the Capital Floor.

#### Capital Target

- 3.23 From 31 March 2025, domestic licensees are expected to meet, or be on a path to meet, the Capital Target equivalent to £115 Adjusted Net Assets per domestic dual fuel customer (i.e., £57.50 per domestic electricity customer and £57.50 per domestic gas customer).
- 3.24 Licensees who are below the Capital Target but above the Capital Floor are not for this reason in breach of the licence condition but are in the Intermediate Position. Being in the Intermediate Position means the licensee must adhere to Transition Controls until they have a Capitalisation Plan accepted by the Authority (see paragraphs 3.39-3.49).
- 3.25 The minimum capital requirement applies to new entrants. New market entrants must demonstrate, within the licence application process, how their business will be financed in accordance with their growth forecasts. As such, we expect prospective new entrants to demonstrate that they are adequately capitalised from the outset.



To the extent they have rapid customer growth plans, we would also expect, therefore, that they will enter the market above the Capital Target.

- 3.26 As with other reporting Trigger Points, and set out in SLC 4B.18, if a licensee is in the Intermediate Position, the licensee must notify Ofgem as soon as reasonably practicable, and at most within seven days of becoming aware that it is in that Position or at Material risk of being in that Position. In addition, the licensee should notify the Authority 28 days before making any Non-essential Payment. For the avoidance of doubt, this standard condition does not prevent existing arrangements which would decrease costs for consumers, such as financially responsible treasury management practices (for example, arrangements where the licensee loans excess cash back on an overnight basis to the centre/group treasury to manage).
- 3.26 We accept that licensees may need to be in the Intermediate Position in times of stress or use it as a transition period when the requirement is introduced for the first time on 31 March 2025. However, Ofgem expects that licensees are only in the Intermediate Position temporarily as it is our policy intention that all licensees will achieve the Capital Target. Any licensee in the Intermediate Position, regardless of the duration, will be subject to default Transition Controls pending the approval of a Capitalisation Plan. If a licensee foresees that its Adjusted Net Assets will fluctuate for a period above and below the Target then we expect that licensee will take this into account in their Capitalisation Plans. That is to say if a licensee expects to only be above the Target for a short period, for example a month, before being below the Target again, a licensee may include that fluctuation in its Plan rather than have to submit two separate Plans.
- 3.27 The level of the Capital Target is based on the minimum level of capital we expect a financially responsible licensee needs to withstand severe but plausible shocks. If there are significant changes in regulation or government policy, such as price cap reform or price protection changes, we will review the capital adequacy requirement to ensure that the level is still appropriate and in the consumer interest. Any change to the Capital Target level will require statutory consultation.

#### Adjusted Net Assets and Alternative Sources of Capital

- 3.28 The Capital Floor and Capital Target are measured as Adjusted Net Assets. The measure of Adjusted Net Assets uses Net Assets as its foundation but **removes intangible assets** and includes permitted Alternative Sources of Capital. It is Ofgem's preference that licensees meet the Capital Floor and Capital Target using equity where possible, as this would imply that the licensee is equity-funded, which is the most resilient form of loss-absorbing capital. However, recognising that

adequate levels of resilience can be provided by non-equity capital, licensees can use Alternative Sources of Capital to meet the Capital Floor and Capital Target provided they can demonstrate that this funding qualifies as an Alternative Source of Capital (see paragraph 3.36 for a list of Alternative Sources of Capital).

- 3.29 We take Net Assets as our starting point for Adjusted Net Assets, as measured according to licensees internal accounting standards (e.g., IFRS or UK GAAP), and reported in licensees' Financial Statements, but excluding intangible assets. This is to say that if a licensee applies a version of IFRS in its statutory accounts, then it should apply the same version of IFRS for calculation of its Net Assets and by extension its Adjusted Net Assets. Likewise, if a licensee applies FRS101 or UKGAAP (FRS 102), it should apply the same standard in calculating the Net Assets and by extension the Adjusted Net Assets.
- 3.30 We understand that licensees accounting standards are different, and some licensees have limited accounting resources, but overall, licensees' valuations of their Net Assets and Adjusted Net Assets should be fair and credible. Our expectation is that reporting in between statutory accounting periods should be consistent with the statutory accounts and if not, then a clear reconciliation is provided back to the statutory accounts. Any reporting of accounts detailing licensees' valuations of their Net Assets and Adjusted Net Assets position should be signed off by the company's chief financial officer and/or a company director.
- 3.31 If a licensee chooses to use Alternative Sources of Capital to meet the Capital Floor and/or Capital Target, they must formally notify Ofgem in writing no later than 8 weeks ahead of the compliance date of 31 March 2025. In the case of new entrants, we expect them to formally notify us as early as possible in the course of the application process if they intend to use Alternative Sources of Capital. After the 31 March 2025 licensees must notify Ofgem at least 8 weeks before the date that their Alternative Sources of Capital are required to comply with the Capital Floor or Capital Target.
- 3.32 The licensee should provide evidence of these agreements and show how these meet the requirements for Alternative Sources of Capital. This includes:
- (i) documentation of the instrument;
  - (ii) an explanation as to how it meets the requirements (unconditional with no drawstop or early repayment conditions, unsecured, has at least 12-month tenor remaining, and if required that it comes from an investment grade parent or group company), with additional evidence if required (such as proof of credit rating);

(iii) a highlight of any key clauses for our attention.

- 3.33 We may ask licensees for further information in addition to that set out in i)-iii) to support our consideration of whether the Alternative Sources of Capital meet our criteria.
- 3.34 Licensees must notify Ofgem as soon as reasonably practicable, but no longer than seven days, after becoming aware of any changes to the terms of their Alternative Sources of Capital. If any changes occur to the approved Alternative Source of Capital that would impact the ability for it to meet the criteria, such as if the credit rating of the guarantee or lending party is reduced below the accepted Investment Grade rating during the length of the contract, this funding source can no longer be used for Alternative Sources of Capital. The licensee must notify Ofgem in writing as soon as reasonably practicable (but no later than seven days) that this source is no longer part of their Capital Target, and if this brings them below the Target or the Floor.
- 3.35 Licensees will be required to provide ongoing evidence that there is a minimum of 12-months remaining on their Alternative Sources of Capital, as part of regular reporting requirements (e.g. the monthly RFI).
- 3.36 The licence sets out what criteria Alternative Sources of Capital must meet to be considered Capital for the purposes of the Floor and/or Target. An Alternative Source of Capital cannot be used to meet the Capital Floor and/or Capital Target until it is approved by us. We have repeated the licence requirements below and explained, against each definition, how we expect to approach the question of whether a particular source of Capital meets the requirement or not. We will consider all instruments submitted to us to ensure that they: (i) come under one of the required definitions below; (ii) fit the intent of providing loss-absorbing capital that provides a buffer during a potential shock and reduces the cost of mutualisation in the event of an insolvency; and (iii) are in the Consumer Interest to accept. Therefore, we expect to approve sources that meet the criteria below, subject to the above conditions.
- **Unsecured loans approved by the Authority** which satisfy each of the following conditions: (i) the loan is not repayable within the following 12 months, and (ii) the relevant lender (nor agent for the lender) has no right to accelerate the loan (including on the licensee’s insolvency or any other event of default or other event).
    - At this time the only unsecured loans we expect to accept are unsecured shareholder loans. We are open to future evidence that

there are unsecured loans from third parties that could also provide a sufficient level of robustness to meet our criteria as a complement to equity financing.

- **The full value of a Parent / group company, committed, unsecured, documented loan facility from a parent / group company to the licensee (drawn or undrawn)**, which satisfies the following conditions: (i) the parent/ group company providing such commitment maintains a minimum long-term credit rating of at least two of the following: BBB- by Standard and Poor's, BBB- by Fitch or Baa3 by Moody's; (ii) the commitment is fully committed under a legally binding commitment letter or facility agreement for at least the next 12 months, and is not subject to any conditions to drawing or payment, and (iii) the parent/ group company has no right to cancel its commitment.
- **Unconditional, unsecured, quantifiable, legally-binding, guarantee from a parent or group company to the licensee to discharge liabilities of the licensee**, which guarantee satisfies the following conditions: (i) the parent/ group company providing such guarantee maintains a minimum long-term credit rating of at least two of the following: BBB- by Standard and Poor's, BBB- by Fitch or at least Baa3 by Moody's; (ii) the guarantee is legally binding for at least the next 12 months, and is not subject to any conditions to drawing or payment, and (iii) the parent/ group company has no right to cancel such guarantee, (iv) any counterindemnity or other obligation by the licensee to parent/ group company in relation to payments by the parent/ group company under such guarantee will comply with the conditions referred to in "unsecured loans" above.

3.37 Credit ratings should be from two of the three institutions: Moodys, S&P, or Fitch. In the case of a split rating, we will base our assessment on the lower rating. A company with a split rating where one is not investment grade rated will not be acceptable.

#### Fuel split

3.38 The Capital Floor and Capital Target applies to all payment and tariff types equally, but it is split 50:50 by fuel type (£57.50 per domestic gas customer and £57.50 per domestic electricity customer). Where a licensee supplies both domestic and non-domestic customers, they should explain in their Annual Adequacy Self-Assessment any split of assets between the supply business for non-domestic supply versus

domestic supply, to help show how the Adjusted Net Assets calculation for the Capital Floor and Capital Target maps across the business, and if there are any implications for the impact of the measure on resilience. Although the common minimum capital requirement does not apply at this stage to non-domestic supply, non-domestic licensees 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.

#### Transition Controls

- 3.39 When a licensee is in the Intermediate Position, they are subject to Transition Controls until they have an agreed Capitalisation Plan in place. Being in the Intermediate Position is not a breach of the licence in itself and we are not going to publish details of licensees who are subject to Transition Controls. These Transition Controls comprise a ban on Non-essential Payments and a ban on customer acquisition (i.e., a sales ban). A licensee may also be subject to other controls when it is in the Intermediate Position. For example, Ofgem may require the licensee to do an independent audit, if its governance is weak or its Capitalisation Plan needs additional assurance. Licensees may also be required to ringfence some/all CCBs (see section 4 of this guidance for more detail on the circumstances in which Ofgem may direct CCB ringfencing).
- 3.40 While these controls will not continue to apply automatically when a licensee has an agreed Capitalisation Plan in place, it is likely that an acceptable Capitalisation Plan will include measures to limit Non-essential Payments (as per the need to include information on how to conserve funds as part of a credible Capitalisation Plan) and measures to manage customer growth (as per the need to include details on customer acquisition and relevant commercial strategy).

#### Capitalisation Plans

- 3.41 As set out in SLC 4B.20, licensees are required to submit a credible Capitalisation Plan when they are in the Intermediate Position. A credible Capitalisation Plan must include, at a minimum, the following information:
- The cause for the licensee being below the Capital Target
  - The level of funds needed to meet the Capital Target
  - How they intend to raise further funds
  - How they intend to conserve existing funds, including limiting Non-essential Payments
  - Whether core business functions will be affected

- The timeframe it would take to recover
- Assumptions on customer numbers and relevant commercial strategy
- Risks to recovering within the proposed timeframe
- The governance arrangements, including who is responsible for taking relevant decisions
- Quarterly Progress Milestones

3.42 The Plan must be time bound with a defined end date, have sufficient supporting evidence of and be of sufficient quality to enable Ofgem to assess compliance – or progress towards compliance. Table 1 sets out what we would expect this to look like in practice (notwithstanding that specific details will vary according to licensee circumstances), namely that a credible Plan should be SMART (Specific, Measurable, Achievable, Realistic, and Time-bound).

3.43 It should be noted that while not all Capitalisation Plans will include bans on Non-essential Payments and sales bans, an acceptable credible Plan for licensees in the Intermediate Position is likely to include some measures to limit Non-essential Payments and manage customer growth

Table 1: Expectation for a credible Capitalisation Plan

	<u>Expectation for a credible Capitalisation Plan</u>
<p><b>Context</b> Background, governance and commercial strategy</p>	<p>-Circumstances that led to the Capital Target breach (e.g., drop in retained earnings or investor pull out etc), and changes made to ensure that this does not reoccur.</p> <p>-Governance structure showing that a decision-making process is in place and decisions are taken at an appropriate level (e.g., Managing Director / Finance Director).</p> <p>-Steps taken to ensure results are enduring e.g., how capital will continue to be met for forecasted customer growth.</p>
<p><b>Specific</b> Plan objectives, funding arrangements and impacts</p>	<p>-Name and details of funding institutions and existing arrangements with the licensee.</p> <p>-List contingency funding sources including providers and existing arrangements.</p>

	<p><u>Expectation for a credible Capitalisation Plan</u></p>
	<ul style="list-style-type: none"> <li>-Details of existing financial arrangements that reduce risk, or provide funding, that are not Alternative Sources of Capital.</li> <li>-Description of funding including key contractual features / limitations.</li> <li>-Budget arrangements showing sources of savings and impact on core business functions (e.g., cuts to sales and marketing budget, staff bonuses, dividends etc).</li> <li>-Milestone commitments, which can include process milestones as well as funding milestones.</li> <li>-Financial projections for the next three Regulatory Years (including the remainder of the current year) to include a forecast balance sheet, income statements, cashflow statements, key financial projections, and the results of any stress tests that the licensee considers appropriate.</li> <li>-Details of mitigating actions the licensee will take to improve financial resilience.</li> </ul>
<p><b>Measurable</b> Success criteria capable of substantiation</p>	<p>-All results should be capable of substantiation, with evidence provided at each milestone review. Substantiation may include copies of funding arrangements, correspondence with funders, evidence of payments etc.</p>
<p><b>Achievable</b> / realistic Evaluation of Plan constraints including programme risks and mitigations and justification to proposed time scale</p>	<ul style="list-style-type: none"> <li>-Assessment of current and forecast financial standing, including resilience to downside scenarios relating to either operational performance or macro-economic events.</li> <li>-Alternative paths to compliance in the event that the preferred source of funding is not secured.</li> <li>-Risk and mitigation register for Plan delivery.</li> <li>-The Plan should be reflection of the licensee business model and resilient position.</li> <li>-Fully substantiated timescales that evidence steps have been taken to make recovery swift.</li> </ul>

	<u>Expectation for a credible Capitalisation Plan</u>
<b>Relevant</b>	-Components of the Plan should directly contribute to achieving the Capital Target
<b>Time bound</b>	-Time scale variation dependent on sourcing options and complexity of raising capital.  -Plan should reflect the shortest reasonable path to compliance.

### Ofgem’s assessment of Capitalisation Plans

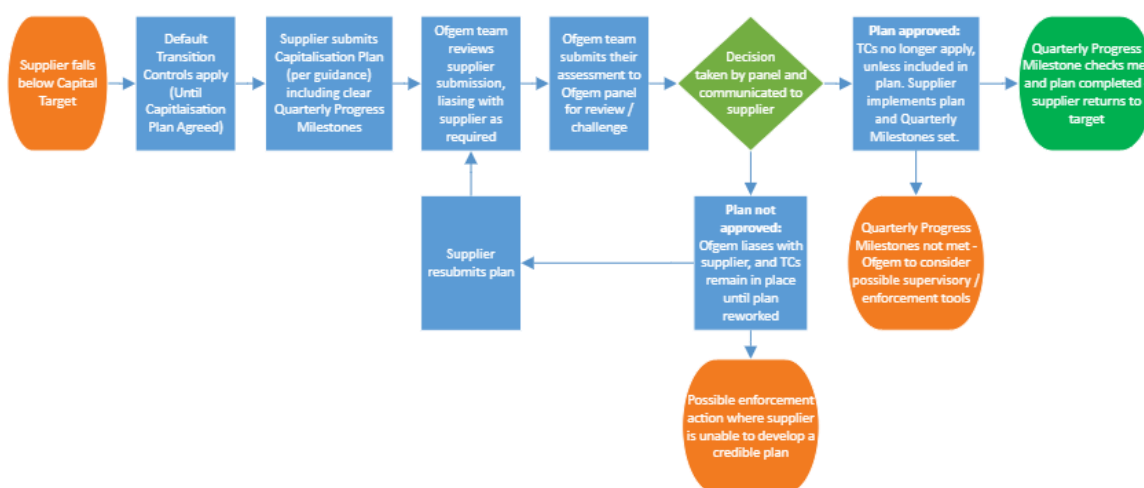


Figure 1 sets out the process by which Ofgem will assess Capitalisation Plans, Quarterly Progress Milestones and Plan change requests.

1. Supplier falls below Capital Target
2. Default Transition Controls apply (Until Capitalisation Plan Agreed)
3. Supplier submits Capitalisation Plan (per guidance) including clear Quarterly Progress Milestones
4. Ofgem team review supplier submission, liaising with supplier as required
5. Decision taken by panel and communicated to supplier.
  - a. **If a plan is not approved:**  
Ofgem liaises with supplier, and TCs remain in place until plan reworked.
    - i. Possible enforcement action where supplier is unable to develop a credible plan. or
    - ii. Supplier resubmits plan. Return to Step 4.
  - b. **If plan is approved:**  
TCs no longer apply, unless included in plan. Supplier implements plan and Quarterly Milestones set.
    - i. Quarterly Progress Milestones not met – Ofgem to consider possible supervisory/ enforcement tools. or
    - ii. Quarterly Progress Milestone checks met and plan completed – supplier returns to target.



*Figure 2: Accessible version of Intermediate Process diagram*

- 3.44 Assessments will be undertaken by and reviewed via a panel process. Assessment panels will be made up of key senior staff across a range of disciplines with the appropriate skill levels to make complex financial judgements, including economists and finance specialists, policy experts and legal advisors. Assessment panels will draw on licensee data, market metrics and wider macro-economic intelligence when making their decisions. The panel structure will align to the Ofgem Delegation Framework, with escalation to senior executive level where appropriate.
- 3.45 In making their assessment of the Capitalisation Plans, Quarterly Progress Milestones, and any other issues related to the Intermediate Position compliance framework, the panel will consider the licensee's business model, wider market conditions, macroeconomic factors, and the Consumer Interest Framework. Ofgem must accept the Plan before it can be put into effect. Ofgem will review the Capitalisation Plan and provide comments, approval or rejection in a reasonable timeframe. We aim to provide written feedback or approval within two weeks of receiving a submission, however this timeline can vary, in particular where escalated assessment is required. Where a licensee submits a Plan that does not contain all the information set out at paragraph 3.41 or where the Plan does not have enough supporting evidence to enable Ofgem to assess whether the plan is credible then it is likely to be rejected. If a licensee submits a Plan that is rejected by Ofgem on the basis that it is incomplete, poor quality and/or unworkable, then it is likely to be in breach of SLC 4B.18 on the basis that it has not submitted a credible Capitalisation Plan to Ofgem.

#### Quarterly Progress Milestones

- 3.46 To monitor progress of the Capitalisation Plan, licensees must report at quarterly intervals and meet agreed Quarterly Progress Milestones. These milestones will be agreed as part of the Capitalisation Plan and will be specific to each licensee but could include metrics such as whether licensees have engaged lenders/shareholders, implemented cost reductions, or made changes to risk strategies in order to put them on a path to meeting the Capital Target. We expect licensees to use metrics that are SMART for their Quarterly Progress Milestones and submit evidence at the quarterly check-in so that Ofgem can assess whether the Milestones have been met. Having evidence based, SMART Quarterly Progress Milestones will help ensure they are assessed fairly and objectively.

3.47 When it has been accepted by Ofgem, the licensee must adhere to its Capitalisation Plan. Once a credible plan is agreed upon by Ofgem and the licensee, the licensee will be held to account at all times for the delivery of the plan until completion. Quarterly Progress Milestones represent formal check-ins between Ofgem and the licensee to assess progress. However, if the licensee deviates from the delivery of their agreed plan at any point Ofgem may take enforcement action (in line with the Enforcement Guidelines and our statutory powers).

#### Amending Capitalisation Plans

3.48 There may be limited circumstances where either the licensee or Ofgem needs to make amendments to the Capitalisation Plan. The party requesting the amendment must notify the other party at least 28 days before the next Quarterly Process Milestone to ensure sufficient time to consider amendments before the quarterly check-in. The circumstances that may require amendments to a Capitalisation Plan would be, for example, significant government policy changes, economic downturns, sector specific developments, significant changes in the licensee's business structure or ownership. The process for amending a Plan is set out in SLC 4B.21 and 4B.22 for licensees and Ofgem respectively.

3.49 We would expect licensees to be tracking their Capital position throughout the year, and that they should be able to provide Ofgem with information about their capital position at any point. 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 licensee is on a credible pathway to compliance before March 2025, or if after March 2025 they are not meeting – or are at risk of not meeting – the Capital Floor and Capital Target.

#### **Reporting requirements**

3.50 As set out in SLC 4B.8 and 4B.11, the FRP includes requirements on licensees to proactively report to Ofgem how they are meeting requirements for ongoing financial resilience. This includes, but is not limited to, the Annual Adequacy Self-Assessment and the Trigger Points. Licensees are expected to report to Ofgem in writing as soon as reasonably practicable (but no later than seven days) after they become aware that there is a Material Risk that any of the Trigger Points, set out in paragraph 3.80 of this Guidance and in SLC 4B.8, may occur or where any of the Trigger Points have occurred. As set out in SLC 4B.17 and 4B.18, licensees must also notify Ofgem within 7 days of becoming aware that they are below the Capital Floor and/or Capital Target or within 7 days of becoming aware that there is a Material risk they will be

below the Capital Floor and Capital Target. Below we set out further detail on expectations for that licensee reporting.

#### Annual Adequacy Self-Assessment

3.51 As set out in SLC 4B.11, to evidence their compliance with the FRP, licensees must provide an Annual Adequacy Self-Assessment (the “self-assessment”), that sets out the analysis that underpins their evaluation of past and future compliance with the FRP’s requirements. The self-assessment should evidence how the licensee has complied with the standard conditions 4B.1, 4B.2, 4B.3, 4B.4, 4B.5, 4B.6, 4B.16 and how it has met the Capital Target or complied with 4B.18 and 4B.20 over the previous 12 calendar months and how it intends to comply with standard conditions 4B.1, 4B.2, 4B.3, 4B.4, 4B.5, 4B.6, 4B.16 and how it has met the Capital Target or complied with 4B.18 and 4B.20 for the next 12 consecutive calendar months. This self-assessment should include, but should not be limited to, providing information on how the licensee:

- Maintains Capital and Liquidity of sufficient amount and Quality to meet reasonably anticipated financial liabilities as they fall due.
- Has Alternative Sources of Capital that meet the requirements that they are currently using, or plan to use over the next 12 months.
- Meets the Capital Floor at all times and meets or seeks to meet the Capital Target.
- Ensures that were it to exit the market or have its licence revoked, that its financial and operational arrangements are such that any SoLR or special administrator appointed on the licensee’s exit would be able to serve its customers efficiently and effectively and that there would be minimised Mutualised costs upon exit.
- Responsibly manages costs at risk of Mutualisation and takes appropriate actions to minimise such costs.

3.52 Licensees can choose to align their self-assessment reporting with their internal reporting cycles. As set out in SLC 4B.12, licensees must submit their first self-assessment by 31 March 2024 at the latest. Thereafter, we expect reporting to be made at least once every 12 months. As set out in SLC 4B.13, licensees must, within 28 days of SLC 4B.13 taking effect, notify Ofgem of the date they intend to submit their first self-assessment.

3.53 The submission date that a licensee notifies Ofgem under SLC 4B.13 will continue to apply unless the licensee notifies Ofgem of a change of date. A change of date is

possible because we expect licensees to review their self-assessment process at least once every 12 months.

- 3.54 If there is a significant change in the licensee’s business or operating model, the licensee may wish to carry out a review promptly before its next scheduled annual self-assessment. For example, if there is a merger between a licensee and another business entity, the licensee should, as part of its preparation for that event, analyse the impact on the licensee’s annual self-assessment process. Similarly, if a licensee’s business undergoes a significant change due to external factors (for example, significant changes in the structure of a market sector), the licensee should consider the effects on its annual self-assessment process in a timely manner.
- 3.55 Licensees should design their internal timetable for the review of their self-assessment process and the submission of their scheduled self-assessment in a reasonable way that reflects proper management of their internal risk.
- 3.56 While Ofgem has provided some flexibility by allowing licensees to report according to their internal reporting cycle, we would expect licensees to ensure that their proposed review and reporting timetable would result in Ofgem receiving the necessary information in an appropriate and timely manner.
- 3.57 With reference to SLC 4B.14, it is important to clarify that a licensee is not permitted to state a revised reporting date that would result in the licensee not submitting its self-assessment report to Ofgem for more than 12 consecutive months. For example, if a licensee has a submission date of 31 March each year and the licensee submits its self-assessment report on 31 March 2024, but on 28 February 2025, the licensee wishes to change its annual submission date to 31 December, this would not be permitted, as the next submission date would be 31 December 2025, which would be more than 12 months after 31 March 2024 (the previous submission date). However, the licensee could have notified Ofgem on, for example, 1 December 2024 that it intended to change its submission date to 31 December. This is because the next submission of its self-assessment report would then have occurred on 31 December 2024, which would be within 12 months of the previous submission on 31 March 2024.
- 3.58 Where a licensee changes the submission date of its annual self-assessment, we would expect the licensee to submit the self-assessment to Ofgem within not more than 28 days of its senior management body having approved the annual self-assessment document resulting from that review. In addition, the licensee is expected to submit documentation of the review showing a clear explanation of any changes to the licensee’s self-assessment process that have occurred following the

review and the reasons for those changes, and an analysis of the effectiveness of the firm's risk management processes during the period covered by the review.

3.59 How a licensee completes its 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:

- The 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 licensee business model and risks.
- The policies and processes a licensee 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 licensee has considered the impact of severe but plausible stress scenarios to those risks.
- Whether the licensee has sufficiently considered and made reasonable assumptions about any risks associated with its identified sources of funding to meet the FRP.
- If reporting sufficiently explains how the licensee 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.

3.60 As set out in SLC 4B.15, 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. This ensures the licensee's directors are responsible for properly assessing the licensee's financial adequacy and compliance with the FRP.

3.61 We would expect the self-assessment to 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.

3.62 Although we will not dictate or prescribe how licensees should evaluate their financial adequacy and FRP compliance and how to report it, the self-assessment should cover:

- Business-specific arrangements and risks (paragraphs 3.63-3.66 below)
- The Capital Floor and Capital Target (paragraphs 3.67-3.69 below)
- Exiting the market, minimising Mutualisation Costs and asset control (paragraphs 3.70-3.71 below)
- Reliance on CCBs (paragraphs 3.72-3.73 below)
- Governance and internal capability, systems, and processes (paragraphs 3.74-3.76 below)

#### Business-specific arrangements and risks

3.63 Licensees 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 licensee's business plan and business-specific risks over the coming 12-month period which the licensee uses to inform their Capital and Liquidity planning to remain compliant with the FRP. A non-exhaustive list of what we would expect to consider includes:

- How the licensee is funding any regulatory obligations.
- The licensee's risk appetite associated with its business strategy, e.g. tariff pricing, hedging strategy, purchasing agreements.
- Identification and explanation of all material business-specific risks, having consideration for the range of risks set out in paragraph 3.5. This includes, for example, explaining how the licensee 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 the licensee has subjected their business projections and risks to severe but plausible stresses consistent with their risk profile. We expect licensees to show reasonable assumptions when discussing how they will manage potential downside risk.
- 3.64 The licensee 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.
- 3.65 The licensee 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 licensee should explain mitigations, and whether it has decided to hold additional Capital or Liquidity against that risk while working towards mitigation. The licensee should also explain the sources of funding they are relying on for their business specific Capital and Liquidity needs, and other risk mitigations.
- 3.66 The licensee should also explain the sources of capital 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 licensee’s business could be subject to. Licensees should have consideration for the Alternative Sources of Capital listed in paragraph 3.33 in relation to the Capital Floor and Capital Target when describing the sources of capital it relies on.

#### Capital Floor and Capital Target

- 3.67 The first Annual Self-Assessment is due no later than 31 March 2024. In this first Self-Assessment, the licensee must set out how the licensee plans to meet the Capital Floor and the Capital Target by 31 March 2025 or have a Capitalisation Plan in place that sets out how they will meet the Capital Target from 31 March 2025. The licensee should include sufficient evidence to enable Ofgem to assess the licensee’s ability to meet the Capital Floor and Capital Target and should consider the points at paragraph 3.59 when providing this evidence.
- 3.68 Thereafter, if a licensee is meeting the Capital Floor and Capital Target, it must continue to evidence, as part of the Annual Self-Assessment reporting, how it is compliant with the Capital Floor and Capital Target over the next 12 months and over the past 12 months.

- 3.69 Within the Annual Adequacy Self-Assessment, the licensee should also explain in its reporting what measures it will take to mitigate the risk of dropping below the Capital Target and Capital Floor as projected. If there is a risk of breaching the Capital Floor and or falling below the Capital Target, the licensee should set out how it would come back into compliance in a reasonable time frame, using the Capitalisation Plan as a guide for what information to include. For the avoidance of doubt, if a licensee is below the Capital Floor it is a breach of the licence and Ofgem has the power to take enforcement action under its broader statutory enforcement powers to bring the licensee into compliance. However, as stated in paragraph 3.23, falling below the Capital Target (provided a licensee is above the Capital Floor) is not an automatic breach of SLC 4B but a licensee is required to submit a Capitalisation Plan.

#### Exiting the market, minimising Mutualisation costs and asset control

- 3.70 Licensees should set out how they ensure that, were they to exit the supply market (due to insolvency, licence revocation or in any other circumstances), disruption to customers and the market would be minimised where possible, that their operational and financial arrangements are in order such that any Supplier of Last Resort or special administrator appointed would be able to efficiently and effectively serve the licensee's customers, and that there would be minimised Mutualised costs upon exit. It should be clear how ensuring these outcomes fits into their business, Capital and Liquidity planning.
- 3.71 Licensees should explain how they are compliant with asset control requirements as set out in SLC 4B.5 and SLC 4B.6 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

- 3.72 A licensee should have the ability to meet its financial obligations while not being overly reliant on CCBs for its working capital. Licensees must report on their reliance on customer credit balances. The Cash Coverage Trigger is a Trigger Point, therefore licensees must notify the Authority within seven days of becoming aware it is below the Cash Coverage Trigger and must not make any non-essential payments.
- 3.73 In their annual reporting, licensees should consider this threshold and whether any of their projections 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

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- 3.74 Licensees should explain how they have established appropriate lines of defence to manage, monitor and assure their directors that they have embedded the internal capability and processes to monitor and mitigate business-specific risks within clear risk appetite levels. The process should incorporate the results of the self-assessment process that drives management accountability. They should explain how their governance process takes these considerations into account in business planning, and Capital and Liquidity planning.
- 3.75 Licensees should also explain any independent internal audit (i.e., an audit function, which is separate and independent from other functions and activities of a licensee's business) capability and how this is used in making judgements about business and Capital and Liquidity planning. For example, licensees could explain the internal independent process they have taken to ensure that their risk management, governance, and internal control processes have operated and are operating effectively to meet their obligations under the FRP. Where internal audit capability is not present, licensees should provide an explanation for its absence and how independent internal assurance is achieved, as well as consider annually whether there is a need for internal audit capability, including making recommendations to the board.
- 3.76 The self-assessment reporting should include a summary of relevant governance arrangements and processes that form the lines of defence and ensure adequate entity level controls with 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, the delegations of authority framework, 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.

### **Trigger Points**

- 3.77 A Trigger Point is an indicator which, upon its occurrence or likely occurrence, requires a licensee to notify Ofgem of this occurrence or likely occurrence so that risks can be proactively managed. We have chosen the Trigger Points (set out in paragraph 3.80 of this Guidance and in SLC 4B.8) such that a licensee will notify Ofgem of risks and issues which may affect, or are affecting, the direction or future outcome of a licensee's financial situation and its ability to meet the FRP. It is the intention that by proactively notifying Ofgem of expected or actual changes to a licensee's financial position that the licensee and Ofgem can better mitigate that risk in the interest of consumers.

- 3.78 Licensees must notify Ofgem in writing as soon as reasonably practicable (but no later than seven days) after the licensee becomes aware a Trigger Point may occur, and as soon as reasonably practicable (but no later than seven days) once it becomes aware a Trigger Point has occurred. Licensees 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. For clarification, this reporting is separate from that of the regular financial monitoring via the monthly RFI.
- 3.79 The Trigger Points are not an exhaustive list of possible indicators that could imply financial deterioration but are designed to encourage licensees to proactively report to Ofgem on risks and issues that may affect or do affect a licensee's ability to comply with the FRP so that swift action can be taken to mitigate the risk or remedy the issue. As per SLC 5A, licensees must be open and transparent with Ofgem and we therefore expect that licensees notify the Authority at any point where there is a change to any aspect of their financial position that could materially impact their current or future ability to be compliant with the FRP.
- 3.80 The Trigger Points are:
- **Any reduction in the licensee's Access to Funds**, where this may impact the licensee's ability to meet standard conditions 4B.1, 4B.2, 4B.3, 4B.4, 4B.5 and 4B.6: As outlined in the licence conditions, Access to Funds means any legally binding agreement which provides the licensee with capital or access to funding to be utilised for their licensable activities. Examples of capital instruments include unsecured shareholder loans, parent or group company working capital facilities and unconditional guarantees. Examples of other funds that provide access to funding include, but are not limited to, parent company guarantees, loans (including senior and subordinated, third party and intercompany), mezzanine finance, working capital facilities, trade finance facilities (including letter of credit, guarantee, factoring and invoice discounting), securitisation facilities, and guarantees. Licensees must notify Ofgem of any projected or actual reduction in Access to Funds that may impact their ability to meet the FRP, as this could significantly affect the financial standing of a licensee. This includes, but is not limited to, where licensees identify scenarios where they may no longer have access to funds from an investor, parent company, bank, or other lenders, or if funds or borrowings have been, or will be, reduced. Upon being notified, Ofgem will consider next

steps depending on the amount that the funding has reduced by and the financial position of the licensee before the event.

- **Any changes with respect to the licensee’s contractual arrangements with counterparties**, where this may impact the licensee’s ability to meet standard conditions 4B.1, 4B.2, 4B.3, 4B.4, 4B.5 and 4B.6: Licensees must notify Ofgem when there is a change (or expected change) in contractual arrangements with counterparties such that it could have an impact on their ability to meet their obligations under the FRP. For example, a breach or likely breach of a covenant in a market borrowing agreement, as well as any change in counterparty agreements that enable access to wholesale markets to trade and hedge. For the absence of doubt, this does not mean that Ofgem should be notified every time a licensee makes a hedging transaction, but rather when, for example, counterparty contracts cease to exist or mature, as well as if there is a default or breach of covenant by a licensee within one, or a detrimental change in terms.
- **Any change that could have a Material adverse effect in respect to the cash position of the licensee:** Licensees must notify Ofgem if there is any change that could have a Material adverse effect (or expected effect) in the cash position of the licensee. For example, if the licensee expects that this change may impact their ability to meet their obligations under the FRP on an ongoing basis, they should inform Ofgem.
- **The Cash Coverage Trigger:** Licensees must notify Ofgem if they have cash in the bank less than 20% of the value of their Gross CCBs from Fixed Direct Debit customers net of unbilled consumption. Ofgem would not expect a licensee utilising financially responsible ‘cash pooling’ practices with their parent group / company, for example by providing an overnight maturity loan, to breach the Cash Coverage Trigger.

3.81 For the avoidance of doubt, licensees should notify Ofgem of any change that affects their ongoing ability to meet the FRP if that change means, for example that they would:

- a. Notify their Board
- b. Notify their investors
- c. Notify their risk committee (in a case where a licensee has a risk committee)
- d. Have to issue equity/debt
- e. Have to get a loan from their parent company

- 3.82 Where a licensee supplies to both domestic and non-domestic customers, they should explain in their Trigger Points notification under SLC 4B.8, as well as their Annual Adequacy Self-Assessment (as set out from paragraph 3.512 in this Guidance and in SLC 4B.10 and SLC 4B.11), how they split assets between their domestic and non-domestic supply. This will help us understand the implications of the licensee’s Trigger Points notification and to make an assessment on the appropriate response.

#### Consequences of the Trigger Points

- 3.83 Once notified, we will consider the Trigger Points alongside the range of information we already collect on that licensee 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 concerns about a licensee’s compliance following notification, we may decide to undertake further assessment and engagement, request an independent audit, and/or move to consider enforcement action where appropriate.
- 3.84 If any of the Trigger Points have occurred, the licensee must notify the Authority, until the Authority has confirmed in writing that such notification is no longer required, 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 licensee of gas and/or electricity to consumers. For the avoidance of doubt, this standard condition does not prevent existing arrangements which would decrease costs for consumers, such as financially responsible treasury management practices (for example, arrangements where the licensee loans excess cash back on an overnight basis to the centre/group treasury to manage).
- 3.85 Using our enforcement powers, we may consider enforcement action which includes restricting the licensee from extracting value from the business as appropriate if requisite to secure compliance with the FRP or other obligations. If a licensee does not hear from Ofgem within the 28 days ahead of the scheduled transaction, the licensee can then proceed with the transaction as planned.
- 3.86 However, if there is concern, Ofgem may seek to use the full list of possible actions, which includes the restriction of certain non-essential payments. The following are some examples of the potential responses that Ofgem would generally expect to make following a Trigger Point notification from the licensee (as set out in paragraph

3.78), or where Ofgem has evidence from its monitoring data that a licensee may be at risk of meeting, or has met, any of the Trigger Points in paragraph 3.80:

- Request the licensee to report additional information to us.
- Request that the licensee cease making non-contractual payments.
- Request that the licensee cease taking on new customers.
- Request that the licensee's parent undertaking provides additional liquid assets for the licensee.
- Request to see licensees' contingency arrangements/alternative arrangements or plans to minimise the risk of disruption to the business. We would generally expect that licensees would have already considered other contingency arrangements or plans.
- Request to see licensees' recovery plan as it is expected that licensees will be considering whether to take or will have already taken any relevant recovery actions.

3.87 The potential actions specified above (in paragraph 3.86) do not prevent Ofgem from taking alternative or additional actions in appropriate cases. The purpose of the potential responses in paragraph 3.86 is to provide greater clarity for licensees on Ofgem's general expectations and approach to interventions, to assist licensees' own planning and responses. Overall, we want to be able to work with licensees to take appropriate actions as Ofgem's intention is to work with licensees to ensure the best outcome for consumers. In certain circumstances, however, we may move straight to enforcement action.

3.88 Where the Cash Coverage and/or Capital Target Trigger has occurred, the licensee may be directed to ringfence a portion of its CCBs, if it is in the Consumer Interest to do so.

### **Financial monitoring**

3.89 In addition to licensee 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 via the Financial Responsibility Principle (FRP) RFI.

3.90 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.

- 3.91 In the case of stress testing, Ofgem expects to send the licensee a notice setting out what information they will be asked to provide a minimum of four weeks ahead of the reporting deadline. A licensee should make sure that its Board is satisfied that the stress tests have been prepared with due care and skill.
- 3.92 For more regular financial reporting, licensees are provided a timetable in advance. If there are changes to the questions, licensees 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 licensees as part of SLC 5.
- 3.93 Licensees 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 licensee 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

- 3.94 We will consider, on a cumulative basis, a range of Supervisory Financial Monitoring, such as Market Compliance Reviews<sup>8</sup> and Milestone Assessments<sup>9</sup> (where relevant) to complement licensee self-assessment reporting and enhanced financial monitoring under SLC 4B to inform our position on a licensee’s resilience. This integrated picture of licensee resilience will underpin our assessment and decision on how to respond.
- 3.95 As highlighted above, we appreciate that there will not be a one-size-fits-all approach to how a licensee 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.
- 3.96 If we have concerns regarding the arrangements a licensee has in place we may seek further engagement and, if appropriate, may agree a suitable reporting arrangement noting licensees’ 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 licensee’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 electricity supply licences. Ultimately, the outcomes of the range of licensee reporting will inform our assessment and decisions/actions. We may also move immediately to consider whether enforcement action is appropriate.
- 3.97 A licensee’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 licensees should also regularly review and update their finance and growth plans and have set out the circumstances under which licensees must notify us as part of the Trigger Points reporting process. However, we also expect to be notified where licensees identify current or potential

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<sup>8</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 licensees.

<sup>9</sup> Under Standard Licence Condition 28C

future financial difficulties that are not included in the list of identified Trigger Points. We strongly encourage licensees to engage with us early.<sup>10</sup>

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

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<sup>10</sup> In accordance with our open and co-operative principle (SLC 5A) we would expect a financially responsible licensee to seek early engagement with us to communicate, and reassure us of, significant changes to its financial position or its approach to financial management.



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

4.1 The following paragraphs explain:

- When the Authority may issue a direction to ringfence a proportion of a licensee's CCBs.
- What a CCB ringfencing direction, if made, will require a licensee 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 issued:

4.2 Where the Supervisory Financial Monitoring data or any data or information Ofgem receives indicates that:

- a) the licensee does not have Cash (in the bank) equal to or greater than 20% of the gross Domestic Customer Credit Balances net of unbilled consumption owed to Fixed Direct Debit customers (based on the average across the month);
- b) the licensee is below the Capital Target or is at Material risk of being below the Capital Target; or
- c) there is Material risk that the thresholds described in (a) will not be met in the next 12 months.

4.3 If a licensee is below of any CCB threshold triggers detailed in paragraph 4.2, we will have the power to direct ringfencing. However, we do not expect it to be in the consumer interest for us to make this direction in all cases. Prior to directing a licensee to ringfence CCBs we will issue a notice of intent to direct. The licensee will have a period of no less than seven days from the date of the notice during which it 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 if required. Following a review of the representation Ofgem will decide whether to issue a direction.

4.4 **Step 1** - We will engage with the licensee to analyse the circumstances of the trigger event and the overall resilience picture and will request any additional data needed to inform a decision to direct. We will consider the wider sector environment such as the normal fluctuations of CCBs, for example, going into a winter period or coming out of a winter period.

4.5 **Step 2** - Where we consider that ringfencing is in the consumer interest we will issue a notice of our intent to direct.

4.6 **Step 3** - Once we have issued a notice of our intent to direct ringfencing, the licensee will have a period of up to seven days to submit a representation. We will consider any representations from the licensee where they consider that ringfencing or the Adjustment Percentage would not be in the Consumer Interest.

4.7 Consumer Interest is the likely impact of any ringfencing 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. Therefore, this would include a consideration of the impact of any ringfencing direction on the licensee’s ability to finance its business.
- 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.

4.8 **Step 4** - Where we do not receive a representation, or we do not agree that ringfencing CCBs would be detrimental to the Consumer Interest, we may issue a direction to ringfence CCBs.

#### Setting the Adjustment Percentage

4.9 The licensee must apply an Adjustment Percentage of 100% unless we consider that this would not be in the Consumer Interest. As above, as part of applying the Consumer Interest test, we will also consider the impact on a licensee’s financeability. Where we have judged that 100% is not in the Consumer Interest, we will direct an Adjustment Percentage of less than 100%.

#### Ongoing monitoring of Consumer Interest

4.10 Our approach to deciding whether to use the power to direct, and at what level to ringfence, will apply to both the Capital Target Trigger and the Cash Coverage Trigger. In the case of the Capital Target Trigger, if we decide not to direct ringfencing we will expect an updated view on the Consumer Interest considerations

through the Quarterly Reporting Cycle. Where only the Cash Coverage Trigger applies, and we have decided not to direct ringfencing, we will put in place reporting requirements to keep this assessment under review and will retain the power to direct ringfencing if the situation changes. Any direction to ringfence CCBs will detail the grounds on which the direction has been issued, pursuant to 4B.23.

#### Implementing CCB ringfencing

4.11 Where we decide to issue a ringfencing 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. 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, or used by a Special Administrator, in the event of failure of the licensee. More than one protection mechanism can be utilised, depending on the circumstances and structure of the licensee.

#### Calculation of Protected Amount

4.12 The licensee will calculate the Protected Amount in accordance with SLC 4D.4 based on Domestic Customer Credit Balances 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.

4.13 When calculating the Protected Amount, the licensee will base the calculation on the Domestic Customer Credit Balances associated with the Domestic Customer Supply Contracts held by the licensee, regardless of where the Domestic Customer Credit Balance funds are held.

#### Timetable for ringfencing CCBs following a direction

4.14 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).

4.15 The schedules for implementing ringfencing of CCBs for the Initial Period and each subsequent calendar month are shown in Table 2 (Timetable for implementation and

ongoing Protected Amount calculation). The schedule is based on calendar days and so weekend days are counted.

4.16 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, we will review the calculation and protection arrangements submitted by the licensee. If, in our opinion, 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 us 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 (published alongside this guidance).
- The submission contains inaccurate or incomplete information.

**Table 2: Timetable for implementation and ongoing Protected Amount calculation:**

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

Example scenario for an initial cycle:

- 10<sup>th</sup> January direction takes effect (Day 1)
- 11<sup>th</sup> January – Data from close of business to be used to undertake calculation (Day 2).

- 23<sup>rd</sup> January – Calculation and protection arrangements submitted to Ofgem (Day 14).
- 23<sup>rd</sup> January to 5<sup>th</sup> February – any issues with the submission to be rectified.
- 6<sup>th</sup> February – protection arrangements take effect, in respect of calculation data from 11<sup>th</sup> January (Day 28).

Example scenario for a subsequent calendar month cycle:

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

- 4.17 In order to reduce costs and simplify the process of establishing Credit Balance Support Arrangements, we have provided templates (published alongside this guidance) which must be used to make the contractual arrangements for licensees' chosen Credit Balance Support Arrangements. These templates reflect the conditions contained in SLC 4D and are published separately as an annex to this Guidance.
- 4.18 Each time a new Credit Balance Support Arrangement is required, licensees must use the current version of the template, which will be available to be downloaded from the Authority's website.
- 4.19 We do not consider it efficient to accommodate bespoke templates and ad-hoc amendments from licensees or their creditors. We may, at times, accept reasonable

amendments at our discretion that do not alter the fundamental tenets of the templates e.g. drawdown provisions, and have been agreed upon at least 28 days before they would be due to come into effect.

4.20 All fields should be completed in full.

4.21 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

4.22 When the Authority is satisfied that the licensee is no longer in breach of the CCB trigger thresholds and / or when there is no Material risk that the licensee will fail to meet the trigger thresholds within the next 12-month period the direction will be revoked.

4.23 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.

- 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 of the licensee that the calculation and Credit Balance Support Arrangements are compliant with SLC 4D.