

# Best Practice Guide

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## Best Practice Guide – Non-Domestic Security Deposits

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Security deposits are one way in which suppliers manage their risk exposure when they determine a non-domestic consumer carries some credit risk. The use of security deposits can be a useful way to ensure a consumer is still able to receive an offer for supply. We are publishing this Best Practice document to guide suppliers and consumers on the practices we wish to see followed.

Publication of this guide was agreed as part of our voluntary actions discussion with suppliers and non-domestic stakeholders. Non-domestic consumer groups requested more transparency, consistency and fairness around security deposits.

### 1. Introduction

- 1.1 Security deposits are one way<sup>1</sup> in which suppliers manage their risk exposure when they determine a non-domestic consumer carries some credit risk. The use of security deposits can be a useful way to ensure a consumer is still able to receive an offer for supply.
- 1.2 Publication of this guide was agreed as part of our voluntary action's discussion with suppliers and non-domestic consumer representatives. Non-domestic consumer groups requested more transparency and consistency around security deposits after a period when more security deposits were asked for and the size of deposits were larger than expected and their calculation unclear. Non-domestic consumers groups also noted that it would be useful to have insight into, broadly, how suppliers may assess their creditworthiness which may lead to a request for a security deposit.
- 1.3 This document, developed with input from both suppliers and non-domestic consumer representatives, sets out best practice for suppliers' use of non-domestic consumer security deposits and how they are calculated, managed and repaid. It aims to make the use of security deposits easier to understand and manage, to the benefit of both suppliers and non-domestic consumers.
- 1.4 This guide is based on the overarching principles of:
- giving consumers **transparency** around a supplier's process and methodology
  - promoting **consistency** in the application of a supplier's practices, and
  - achieving **fairness** in the outcomes consumers receive relative to their credit risk

#### Application

- 1.5 The Guide recognises suppliers' need to be able to manage their credit risk in order to supply consumers, and that processes to manage credit risk across different classes of consumers may differ. Non-domestic consumers range from microbusinesses up to very large industrial and commercial energy users, and they will have differing complexity of contracts and different types of credit risk.

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<sup>1</sup> Other ways suppliers manage risk include credit insurance, bank guarantees and up-front payments

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This means that some supplier processes may vary for different classifications of non-domestic consumers but where suppliers are following best practice, processes would be consistent where these consumers share similar characteristics. For some of the largest consumers in particular, complex arrangement may require bespoke security deposit arrangements that may mean some of the details in this guide do not apply. Nevertheless, the same principles of transparency, consistency and fairness should apply, within a consumer's characteristics or contract type.

- 1.6 We note that purchasing and commercial arrangements<sup>2</sup>, including the use of security deposits, can be facilitated through an intermediary or TPI. This means that some of the actions set out in this guide for suppliers are sometimes carried out by intermediaries or TPIs acting on their behalf. We urge suppliers to make the intermediaries or TPIs they work with aware of this guide and, where applicable, for intermediaries or TPIs to seek to achieve this best practice.
- 1.7 While the Guide focuses on security deposits, suppliers wishing to demonstrate best practice when using other measures to manage credit risk would apply similar principles of consistency, transparency and fairness.
- 1.8 This guide is voluntary, although Ofgem encourages suppliers to follow this best practice as closely as possible. We will monitor the actions suppliers take to manage their credit risks, including in this area following publication of this guide and will not hesitate to take steps to strengthen rules in line with our due processes, if evidence suggests this is needed.

## 2. Assessing a consumer's creditworthiness

- 2.1 Suppliers following best practice would communicate to a non-domestic consumer that has applied to enter into a contract in an appropriate format, in a timely, clear and easy to understand way, the process by which they will assess their creditworthiness. In doing so, suppliers would set out the estimated time to carry out the creditworthiness assessment and to notify the consumer of the result.
- 2.2 It would be helpful for suppliers to also publish the high-level process on their website, recognising this may vary depending on consumer classification or

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<sup>2</sup> We also note that any documentation in relation to their specific offer or revised terms would likely be the primary means of communication

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contract types, and that some details may be commercially sensitive and thus not appropriate to publish in this way.

2.3 The process of assessing creditworthiness may include some or all of the following:

- credit checks, for example whether these are done and how they are done;
- an individual consumer assessment of the financial risk a consumer represents to the Supplier in not fulfilling its contractual obligations in a timely manner
- independent assessment which may be carried out by insurance underwriters (in particular for some larger consumers)
- whether or not there is the potential for reassessments of a consumer's creditworthiness during the term of the contract, to be initiated by either party (for suppliers following best practice these reassessments would be in line with this guide)

### 3. Requesting a security deposit

3.1 If, after carrying out an assessment, the supplier intends to ask for a security deposit, to follow best practice they would communicate in writing to the non-domestic consumer who has applied to enter into a contract in a timely, clear and easy to understand to understand way:

- that the supplier has carried out an assessment of the consumer's creditworthiness and credit risk has been identified as they have not met the necessary threshold
- the basis under which it is requesting a security deposit and the level being requested, including how it has been calculated (see Section 3)
- when their security deposit will be repaid (see Section 6 for further details on this)
- whether the supplier can offer alternative measures or options (where available) to manage the credit risk and, if so, how the consumer can request alternative measures or options to mitigate credit risk if security deposits are not preferable, including any changes to contractual terms.

3.2 The decision of whether a security deposit is required, and its size is ultimately the decision of the supplier, but will be a factor that a consumer may take into account if they are considering alternative offers.

### 4. Calculating security deposits

- 4.1 To follow best practice, the size of security deposits would vary based on the threshold or level of credit risk assessed for a specific non-domestic consumer (see Section 1).
- 4.2 The size of a security deposit can also vary depending on the billing and payment terms of a consumer. For example, a monthly billed consumer would likely face a lower security deposit than a consumer who is billed quarterly, all other factors being equal, given the bill values that could accumulate for an unpaid bill would be greater for a quarterly-billed consumer.
- 4.3 Where suppliers have supplied us with details of their policies, some indicated that security deposits would be calculated based on 3 months' estimated consumption, which was linked to the time it would take to disconnect a consumer after non-payment. Ofgem may update guidance on reasonable levels following the collation of more information. But in the meantime, it is important that suppliers are clear about what process they follow, and the implications of the factors they take into account when setting their levels. Amongst other benefits, this can help facilitate conversations about options for reducing the level of security deposits, for example via changing the billing frequency. It can also reduce perceptions of unfair levels being requested.

### 5. Re-evaluating security deposits

- 5.1 Where there is potential for re-assessment of a consumer's creditworthiness during the term of the contract, suppliers following best practice would allow for non-domestic consumers to request a partial or full refund of their security deposit during the term of their contract following a material improvement in credit worthiness, setting out clearly the procedure for making such a request and what evidence would be needed. Evidence could include ways in which the customer could demonstrate a material improvement in the non-domestic consumer's financial position, or a change in payment terms. Suppliers following best practice would consider and respond promptly within a reasonable timeframe to requests for security deposits to be re-evaluated in accordance with its established methodology. Suppliers would be clear on how long this evaluation would take and the reasons for the length.

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- 5.2 Should the revised required security deposit be lower than that already paid, the supplier would refund the difference to the consumer's account promptly after updating the creditworthiness assessment. We note that this review of a consumer's creditworthiness may also result in a higher security deposit assessment if the established methodology returns a higher value. This is another reason for suppliers to provide enough information about their assessment to inform a consumer of the likelihood of there being an opportunity to release capital held in security deposits, following a re-assessment.
- 5.3 Suppliers may apply their discretion to re-evaluations and are not expected to repeatedly re-evaluate the need for a security deposit in response to multiple and frequent requests by a consumer.
- 5.4 Where a supplier's processes include the potential that they carry out a re-assessment of a consumer's credit worthiness during the term of a contract, to follow best practice, they would have communicated this to the consumer, including the process by which they will re-assess their creditworthiness, when the consumer applies to enter into a contract (see Section 1). We would only expect this to happen where there was a strong commercial need for this to happen. If, following a reasonable re-assessment, the Supplier considers that there has been a material and lasting change in the credit worthiness of that consumer, it may request payment of a security deposit (if one was not previously requested) or of a different security deposit. To follow best practice the Supplier would follow the best practice set out in Sections 2 and 3 for requesting and calculating this new or different security deposit, giving the consumer a reasonable timeframe to make the payment.

## **6. Holding security deposits**

- 6.1 It is expected that suppliers adhere to the Financial Responsibility Principle (SLC 4B).
- 6.2 Suppliers should at all times manage responsibly monies held through security deposits and have adequate financial arrangements in place to be able to return security deposits to their relevant non-domestic consumers within a reasonable timeframe.

## **7. Managing security deposits**

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- 7.1 The application of security deposits should only be commensurate with the credit risk faced by the Supplier. The need for a security deposit is removed once a meter point has moved off supply and all charges and payments related to the portfolio have been cleared.
- 7.2 Suppliers following best practice would be clear whether the security deposit can be used to pay final charges and any debt. If this is possible, this is recommended as it places less burden on non-domestic consumers who may need to pay a security deposit to a new supplier. In this case, a supplier following best practice would highlight the existence of a security deposit on the final bill and not rely on a consumer to request it.
- 7.3 If it is not possible to offset final payment with the security deposit, suppliers following best practice should repay the security deposit promptly once the final bill has been settled and any debts cleared (ie. when a consumer account is closed).

## 8. Non-domestic consumer actions

- 8.1 In order to aid effective management of security deposits, it is recommended that non-domestic consumers undertake steps which may include:
- Responding within a reasonable timeframe to any reasonable requests for follow up information from the supplier, including financial information. It is helpful if consumers respond to information requests from suppliers both during and after the end of the supply contract, until all security deposit money is returned.
  - Lodging any security deposit within a reasonable timeframe and in accordance with instructions provided by the supplier.
  - When moving out of a premises, notifying their energy supplier as soon as possible and giving them a meter reading for all associated meters, ideally taken on the last day of their occupancy or tenancy. This will help to ensure that consumers are only billed for the energy used and allow the supplier to close the account and return the security deposit as soon as possible. Accepting an offer for a Smart or AMR meter will aid accurate and timely billing and consumption management
  - Updating their accounts at Companies House in a timely manner.

### 9. Next steps

- 9.1 We would like to see suppliers assess their current processes with regards to security deposits and consider where they could improve them to meet these best practice expectations.
- 9.2 We thank all suppliers and consumer representative groups for feeding into the development of this best practice guide. Through our monitoring we will assess the extent to which it is driving more transparent, consistent and fair practices.