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Date: 22 March 2021

Dear colleagues,

## **Supply Licensing Review: Final Guidance on the Financial Responsibility Principle**

In November 2020, we published our decision on the Supplier Licensing Review: Ongoing requirements and exit arrangements,<sup>1</sup> these reforms are part of our move to improve customer service standards and minimise the likelihood and impact of disorderly supplier failure. The new requirements took effect from 22 January 2021.<sup>2</sup>

The Financial Responsibility Principle (**FRP**) was introduced as part of the Supplier Licensing Review (**SLR**) reforms. The FRP acts as an over-arching obligation – supporting one of the key aims of the SLR by ensuring suppliers act in a more financially responsible manner and take steps to bear an appropriate share of their risk. Alongside the SLR decision we consulted upon draft guidance on the FRP.<sup>3</sup>

We are now publishing the final guidance for the FRP. The guidance provides information to support suppliers in identifying appropriate actions to take in meeting their obligations under the principle. However, the guidance does not modify or replace the conditions in the gas and electricity supply licences. Neither is it an exhaustive list of supplier obligations. Suppliers should continue to refer to the conditions outlined in the most recent versions of the gas and electricity supply licences.

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<sup>1</sup> Ofgem, November 2020, [Decision on the Supplier Licensing Review: Ongoing requirements and exit arrangements | Ofgem](#)

<sup>2</sup> The Customer Supply Continuity Plans requirement took effect on and from 18 March 2021.

<sup>3</sup> Appendix 3 of the Decision document

## Overview of consultation responses

We received six responses to the consultation, one of which was confidential. Non-confidential responses are published on our website.<sup>4</sup> The majority of respondents welcomed the opportunity to comment on the draft guidance. A summary of responses and our views can be found in Appendix 1.

We have taken account of all responses and made several amendments to the guidance document. Appendix 2 contains a summary of amendments made.

A number of comments were made related to the implementation, monitoring, and enforcement of the principle. We are considering these as we further develop our risk-based approach, and respond to them in Appendix 1. We remain committed to using a proportionate approach and, wherever possible, we will seek to use information that we already gather from other regulatory procedures or tools we already have in place, rather than request new information. However, it is vital there is flexibility in our approach to ensure we can evolve as our wider reporting changes or to allow us to respond to changes in market conditions or unforeseen and unexpected events.

Several respondents made comments regarding the introduction of more prescriptive measures. The new principle will enable us to take action at an earlier stage where suppliers are behaving in a financially irresponsible manner. However, we recognise it may not, by itself, provide sufficient certainty that suppliers have in place appropriate protections to prevent the need for cost mutualisation in the event of their failure.

We have published a consultation on credit balance cost mutualisation protections<sup>5</sup> and, jointly with the Department for Business, Energy and Industrial Strategy, intend to consult on both potential regulatory and legislative based changes to the Renewable Obligation (RO) to reduce the likelihood and scale of cost mutualisation arising from that scheme.

Yours faithfully,

**Barry Coughlan**  
Head of Licensing Frameworks

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<sup>4</sup> [Supply Licensing Review: Final Guidance on the Financial Responsibility Principle](#)

<sup>5</sup> [Supplier Licensing Review: reducing credit balance mutualisation | Ofgem](#), March 2021.

## **Appendix 1: Summary of Consultation Responses**

### ***Main themes***

We received six responses to the consultation, one of which were confidential. Non-confidential responses are published on our website.<sup>6</sup> The majority of respondents welcomed the opportunity to comment on the draft guidance. One respondent stressed that the guidance should be published somewhere prominent. The guidance document will be accessible from the SLR consultation page on the Ofgem website.<sup>7</sup>

Respondents raised the following main themes:

- Clarifications on the scope of the principle and whether we could define further some of our expectations.
- Suggestions on the approach we should take to implementation, monitoring and enforcement.
- Comments that relate to the introduction of further prescriptive measures.

### ***Clarifications***

One respondent specifically sought clarification on whether the principle only covers policy costs and credit balances, and not all costs that can be mutualised. Another respondent felt it was important that any plans are thorough in approach and should cover all industry payments, including those to third parties.

One respondent requested that we provide further definition of what an over-reliance on credit balance means or what good practice could be, and that we also set out how regularly companies should be reviewing their financial arrangements. A few respondents suggested the guidance document could include worked scenario-based examples. Another stressed that we should not only scrutinise suppliers' plans but also assess their ability to pay, based on whether the funds are available when needed.

One respondent suggested amendments to the proposed wording on the minimum expectations of suppliers. They commented that the red-lines should be targeted at those suppliers displaying behaviours suggesting they may be financially irresponsible, and that if the red-lines are crossed Ofgem will investigate and potentially face enforcement action.

### ***Our response***

The definition of "Mutualised" was introduced as part of the licence changes,<sup>8</sup> credit balances and government schemes are provided as examples, but the principle could apply to other costs that are mutualised by regulatory mechanisms. However, this does not cover all third-party costs, we would expect a financially responsible supplier to ensure it is

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<sup>6</sup> [Supply Licensing Review: Final Guidance on the Financial Responsibility Principle](#)

<sup>7</sup> [Decision on the Supplier Licensing Review: Ongoing requirements and exit arrangements | Ofgem](#)

<sup>8</sup> Licence Condition 1 - "Mutualised" meaning one or more market participants other than the licensee bearing costs incurred by the licensee, which may include Customer Credit Balances and costs incurred by the licensee under government environmental and social schemes, by virtue of regulatory mechanisms.

managing all its costs sensibly, irrespective of whether they may be mutualised or within the definition of the principle.

How a supplier meets the obligations under the principle and the evidence they provide will vary by size, business model, and in response to external factors. For example, if a company is new and growing it might be appropriate they review their plans more frequently than one that is in a relatively steady state, or all companies may review their financial plans more regularly in response to an unexpected event that has financial impacts.

We would expect a financially responsible supplier to be reporting internally on the sustainability of its business model and its financial plans, as appropriate to the specific business circumstances. We do not intend to be prescriptive in how suppliers embed the new principle, it should place little or no additional burden on either domestic or non-domestic suppliers that are already acting in a financially responsible manner. In most cases, demonstrating compliance with the FRP would draw upon the supplier's existing information and reporting that it undertakes.

Our expectations regarding suppliers' use of customer credit under the new principle would be considered alongside existing obligations on suppliers to review fixed direct debit payments so that they are set at the right level, and to ensure they are able, where reasonable, to refund credit balances on request.<sup>9</sup> We are currently consulting on more prescriptive measures on domestic credit balances. We will review and update the FRP guidance as appropriate, and this may include an alignment with our thinking on more prescriptive measures if they are introduced.

We can see the value in scenario-based examples and this is something we may include in a future update of the guidance if appropriate. We agree it will be important to assess suppliers' plans and their ability to pay, it is likely we would use the FRP with the other principles and other tools introduced as part of the SLR, such as milestone and dynamic assessments or independent audits, if the evidence provided indicated further investigation might be needed.

We have reviewed the proposed wording to the supplier expectations section and made some minor changes to make it clearer that where we seek assurances suppliers should be able to provide evidence to demonstrate they are meeting these minimum requirements under the principle, and strengthened the wording regarding investigations and enforcement in the document. We have not changed the wording in relation to pricing and credit balances as we did not think these made a material difference to our approach. A decline in customer service would be reported under our wider compliance monitoring and would inform our risk-based approach, and we have added a reference to this in the guidance document.

### *Implementation, monitoring and enforcement*

Most respondents shared views on the implementation and monitoring approach. One respondent commented that the only way to ensure all suppliers are financially responsible

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

is by undertaking specific monitoring of the principle. A few expressed the view that a risk-based approach should mean we use our existing sources of information to identify suppliers about whom we have concerns, and any additional requests for information should focus on the specific concerns we have identified.

Some suppliers made comments suggesting that any additional reporting should be proportionate, given the current COVID-19 financial reporting. One requested that we consult on a draft of any RFI with industry beforehand, unless it has sufficiently robust justification to request the information on an urgent basis. One respondent, although agreeing that non-domestic suppliers should be covered, commented that the reporting should be less burdensome for those suppliers.

One respondent sought assurance that Ofgem will, in monitoring compliance with, and enforcing, the new principle, take into consideration the different business models that exist in the market. Another commented that it is important for Ofgem to communicate as openly and transparently as possible with suppliers around defaults (acknowledging any commercial sensitivities), to allow remaining suppliers to plan for potential mutualised costs which may arise from a supplier failure, and to deter further instances of non-compliance.

Most of the respondents made comments in relation to ensuring that appropriate compliance and enforcement action is taken at the earliest opportunity to reduce the likelihood of issues progressing to a point where it is too late for us to take any meaningful action.

#### *Our views*

We are aware of the burden that information requests can have on a supplier. Wherever possible, we will seek to use information that we gather from other regulatory procedures or tools we already have in place, rather than request new information. Where it is appropriate to request additional information, we will be proportionate, consider reasonable times frames, and where possible provide draft version of requests for information.

We agree that a risk-based approach, targeting those suppliers where there are concerns is likely to be the most proportionate and appropriate approach. However, it is vital there is flexibility in our approach to ensure we can adapt as our wider reporting changes or to allow us to respond to changes in market conditions or unforeseen and unexpected events.

We agree that our monitoring approach for non-domestic suppliers should be proportionate to the risk of mutualisation – given that credit balances for non-domestic customers cannot be recovered through Last Resort Supply Payments, and in any event tend to be proportionately lower than domestic credit balances.

We continue to encourage innovation and appreciate that suppliers' business models will vary. We appreciate that there will not be a one-size-fits-all approach to how a supplier should run its business. We accept that how a supplier demonstrates it is meeting its obligations under the principle and the evidence they provide will vary accordingly.

Where we have concerns and potential risks, we will look to use our powers to intervene to protect consumers and reduce potential cost mutualisation. We may seek further engagement, and if appropriate may agree a suitable reporting arrangement. Where we

have concerns about a supplier's compliance with this principle, we may then decide to undertake a dynamic assessment, request an independent audit, or move immediately to consider whether enforcement action is appropriate. The communication of defaults will depend on the nature and type of default. In some instances, it is likely to be more appropriate for the body overseeing the payment to communicate any defaults, and commercial sensitivities will need to be taken into account.

#### *Further Prescriptive Measures*

Most of the respondents made comments in relation to the introduction of further prescriptive measures. Some felt the principle will not provide sufficient protection to mitigate the risks of costs of irresponsible suppliers being mutualised. One commented that we will need to consider the interaction between the principle and prescriptive measures. Another respondent stressed the need for an impact assessment to be published alongside any proposals.

#### *Our views*

We are currently seeking views on our proposals for further protections on credit balance cost mutualisation, and our analysis of the cost impacts. As part of this work we will consider the interaction of any proposals with the FRP.

## Appendix 2: Summary of changes following consultation

The table below summarises the changes we have made to the guidance document and the reasons.

Paragraph	Change	Reason for change
1.1 and 1.3	Removal of references to consultation.	This is the final version of the guidance and we have taken into consideration consultation responses.
2.3	Added sentence referring to the link to our other regulatory powers and tools and taking enforcement action.	Providing clarity how FRP will work with other regulatory powers and tools, and that we will take enforcement action if appropriate.
3.2	Added a footnote referring to price and indicators of customer service.	Pricing below cost and a deterioration in customer service are both indicators of possible issues with a supplier, and it is likely these sorts of information will inform any risk-based approach.
3.2	Added a sentence clarifying the purpose of collecting information.	Providing clarity why we would be requesting and collecting any information.
3.3	Added reference to innovation	We have clarified that we remain committed to encouraging innovation and appreciate that suppliers' business models will vary and that there will not be a one-size-fits-all approach.
4.2	Added reference to where we seek assurance	This provides clarification that we will be targeting additional information requests where we have concerns.
4.5	Added reference to further investigations and enforcement action.	Strengthening the wording to make it clear we will take further action and use our enforcement powers if appropriate.
5.2	Removed reference to our intention to consult.	We have now published our consultation on further prescriptive measures.