Guidance

Financial Responsibility Principle guidance			
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This guidance document is intended to clarify to suppliers how the Financial Responsibility Principle will be implemented and show how it fits in with our existing regulatory framework. It will cover the aspects which the new principle-based approach will cover, in addition to how Ofgem will approach the assessment of a supplier.

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1. Introduction

1.1. The Financially Responsibility Principle (SLC 4B1 to 4B3) is an enforceable overarching rule requiring suppliers to take action to minimise the extent of costs to be mutualised in the event of failure. This guidance is relevant for all domestic and non-domestic suppliers.

1.2. Ofgem may update this guidance from time to time following consultation - Suppliers are therefore responsible for keeping up to date with the latest version. We remind all suppliers that this guide 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.

2. What is the Financial Responsibility Principle?

2.1. We want to ensure that the costs of a supplier's business are borne by the business itself, rather than being subsidised, on its failure, by its competitors. Features of the retail energy market mean that some supplier costs risk being mutualised upon its failure if they are not managed responsibly while the supplier is trading. Customer credit balances, network charges and environmental and social scheme obligations are examples of this.

2.2. In line with the overarching themes of the Supplier Licensing Review, we want suppliers to bear an appropriate share of their risk, including by adopting responsible financial management approaches to minimise the extent of cost mutualisation in the event of their failure.

2.3. The Financial Responsibility Principle will act as an over-arching obligation – supporting one of the key aims of the Supplier Licensing Review by ensuring suppliers act in a more financially responsible manner and take steps to bear an appropriate share of their risk. Introducing this new principle allows Ofgem further regulatory powers, along with other tools such as milestone and dynamic assessments, to take enforcement action where we see irresponsible behaviours in the market.

3. Implementation

3.1. The Financial Responsibility Principle was introduced into the gas and electricity supply licences in early 2021, in line with several other changes being made by Ofgem as part of the Supplier Licensing Review. The introduction of this new principle will allow Ofgem to request further information from a supplier to ensure it is acting responsibly financially, thus reducing the risk of potential consumer harm and having a negative effect on the GB energy market.

3.2. We are aware of the burden that information requests can have on a supplier. 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. This could include, for example, assessing information we gather as part of our general market monitoring[1] or using information gathered via milestone/dynamic assessments, previous information requests, account management engagement, and/or information contained in Consolidated Segmental Statements. We would also expect to request any additional information in a consistent format. We do not expect the introduction of this principle to result in significant burden to a supplier, especially those who regularly provide clear and accurate information to Ofgem, and that are already acting in a financially responsible manner.

3.3. We continue to encourage innovation and appreciate that suppliers' business models will vary. For these reasons, we plan to approach monitoring in a risk-based and proportionate way. Many factors will be taken into consideration, such as size of organisation and customer base/type. Our monitoring approach for non-domestic suppliers will be proportionate to the risk of mutualisation – given that credit balances for non-domestic customers are not recovered through Last Resort Supply Payments, and in any event tend to be proportionately lower than domestic balances.

[1] "Market monitoring" includes a number of key indicators to assess risk, such as customer service performance, tariff pricing, customer numbers etc.

4. Expectation of suppliers

4.1. The Financial Responsibility Principle requires suppliers to have adequate financial arrangements in place to meet costs at risk of being Mutualised.[2]

4.2. Where Ofgem seeks assurances that a supplier is adhering to the Financial Responsibility Principle, we would expect that the supplier would be able to provide evidence that it has:

- plans in place to meet its financial obligations under government schemes by relevant dates;[3]
- effective processes, that are consistent with existing licence requirements,[4] for example setting direct debit levels and for checking and returning customer credit balances;[5]
- sustainable pricing approaches that allow it to cover its costs over time, or if it is pricing below cost that the risk sits with investors and not consumers. We will need to see evidence that suppliers can finance their overall business plans;
- robust financial governance and decision-making frameworks in place; and
- the ability to meet its financial obligations while not being overly reliant on customer credit balances for its working capital.

4.3. We would expect suppliers to be able to demonstrate they are meeting these minimum requirements under the principle. How a supplier does this and the evidence it provides will vary, but we expect suppliers to provide plans and supporting evidence, for example cash flow projections, budgets, guarantees or proof of investments as appropriate. If a supplier is acting in a financially responsible manner this should just require it to report on the arrangements it has in place and provide evidence to substantiate these plans.

4.4. As highlighted above, we appreciate that there will not be a one-size-fits-all approach to how a supplier should run its business. However, where we see poor practice and

[2] "Mutualised" is defined in the Licence as 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.
[3] The Financial Responsibility Principle covers both costs that could be mutualised following supplier failure and those that may be mutualised if paid late. For instance any Renewables Obligation buyout fund payments that are not made by the end of October will be mutualised whether or not the supplier has failed.
[4] 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".
[5] Under Standard Licence Obligations 27.15 and 27.16.

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.

4.5. If we have concerns regarding the arrangements a supplier has in place, we may seek further engagement, and if appropriate may agree a suitable reporting arrangement. Any additional reporting would be proportionate to the risk of mutualisation and assessed on a case-by-case basis. Where we have concerns about a supplier's compliance with this principle, we may decide to undertake a dynamic assessment, request an independent audit, or move immediately to consider whether enforcement action is appropriate.

4.6. A supplier's financial circumstances will fluctuate over time. In order to adhere to the Financial Responsibility Principle, we expect all licensees to be open and transparent with us on an ongoing basis. We expect that suppliers should also regularly review and update their finance and growth plans. Where suppliers identify current or potential future financial difficulties, we strongly encourage suppliers to engage with us early.[6]

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

5. Potential further cost mutualisation protections

5.1. The Financial Responsibility Principle will help to ensure that suppliers adopt sensible practices in managing their costs. In doing so, it will raise standards among poor performing suppliers without placing an undue burden on suppliers that are already acting in a responsible manner. By itself, we consider it will improve our ability to take action to address poor supplier behaviour. However, we are considering whether further requirements are necessary.

5.2. Introducing the Financial Responsibility Principle at this stage will deliver positive changes for consumers in the short term that can be supplemented later should we decide that is warranted. We will review and update this guidance as appropriate, and to align with our thinking on more prescriptive measures.

[6] In accordance with our proposed open and co-operative principle (SLC 5A) we would expect a financially responsible supplier to seek early engagement with us to communicate, and reassure us of, significant changes to its financial position or its approach to financial management.