Decision

Decision on Strengthening Financial Resilience

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We consulted from 25 November 2022 to 3 January 2023 on a number of measures designed to strengthen the financial resilience of the energy supply market. The consultation proposed introducing a capital adequacy regime, incorporating both an enhanced Financial Responsibility Principle and a common minimum capital requirement, a market-wide obligation to ringfence Renewables Obligation receipts attributable to domestic supply and powers to direct ringfencing of Customer Credit Balances.

This document sets out our decision to proceed with ringfencing of Renewables Obligation receipts and the introduction of the enhanced Financial Responsibility Principle.

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Foreword

The volatility we have seen in wholesale energy markets has had a profound effect on the retail sector: challenging its business models, practices, and approach to risk. It has also had a very negative impact on consumers struggling to afford the energy they need.

To move the sector to a more financially resilient place, so we do not see the kind of supplier failures we saw last winter, we need to reform our retail market to better withstand this volatility. This is aimed at ensuring both that suppliers are less likely to fail and that if suppliers do fail, costs to consumers are minimised and thus energy bills are kept as low as possible.

Having consulted on a package of proposals in November, we have decided to establish an enhanced Financial Responsibility Principle, changing the culture of reporting by placing the onus on suppliers to identify issues early, mitigate their business-specific risks and look longer term how they will comply with their obligations. We are also creating a market-wide obligation for suppliers to ringfence Renewables Obligation (RO) receipts attributable to domestic supply, aimed at reducing the risk of misuse of these receipts as cheap working capital.

These changes are aimed at increasing the resilience of energy suppliers and supporting a successful, competitive, and innovative market, able to produce different kinds of services.

To ensure these new requirements are implemented, we will be ramping up our monitoring, compliance and enforcement activities, moving quickly to improve the capitalisation of retailers, but also providing reasonable plans for transition to allow companies to make the necessary changes. We will continue to work closely with the sector to refine our approach and are setting out further proposals on the minimum capital requirement and the direct ringfencing of customer credit balances alongside this decision document.

The responses to our consultation were varied, with some saying Ofgem is going too far, others that we are not going far enough. Ultimately however, we have a responsibility to protect consumers by ensuring the retail sector is as robust as it can be, developing a market that is more attractive for innovation and investment, with better capitalised, sustainable business models that will prevent additional costs being passed on to customers. At a time of very high energy bills, that responsibility is more important than ever. With this decision, and working closely with government, industry, consumer groups, and charities, we look forward to taking that crucial work forward.

Neil Kenward

Director for Strategy and Interim Director for Markets

Executive Summary

The effects of the energy crisis have been wide-reaching across the industry. Exceptional volatility in wholesale prices has presented challenges to all energy retailers, and high levels of market exit have subsequently imposed further costs on consumers at a time when, in the midst of a cost-of-living crisis, they are least able to bear them.

While the level of wholesale price rises would have inevitably seen some failures in recent years, we have been transparent that tougher standards and controls should have been in place to ensure financial resilience, and that our methods of regulation need to evolve. Our Forward Work Programme for 2022/23[1] committed to reforms to bring in tighter controls and improve financial resilience. We also signalled in our Forward Work Programme that while we recognised some companies would need time to transition, we intended to bring in these reforms at pace.

With this decision, we deliver on that commitment by striking the right balance between implementing necessary new measures now to enhance financial resilience, but also seeking further insight where necessary to ensure the pace of delivery and measures used are optimal given the ongoing challenging circumstances. Suppliers are ultimately responsible for their businesses and need to take all steps to build a resilient business, but this decision sets out a framework to help achieve this. This decision is also part of a broader programme of work to delivery stability to the market and ensure positive outcomes for consumers, including price cap reform, consulting on changes to the EBIT allowance and wider stress testing and compliance work to ensure financial stability of energy suppliers.

Building on our June 2022 policy consultation, our November 2022 Statutory Consultation set out revised proposals to address the issue of suppliers operating in the market without sufficient capital and unsustainable business models being exposed to market shocks, making them unacceptably vulnerable to failure.

Implementation

We have decided to implement an enhanced Financial Responsibility Principle (Enhanced FRP), imposing a positive obligation on all suppliers to evidence that they have sufficient business-specific capital and liquidity so that their liabilities can be met on an ongoing basis. This builds on the current FRP which requires suppliers to manage responsibly costs that could be mutualised and take appropriate action to minimise such costs. The

[1] Forward Work Programme 2022/23 | Ofgem

enhanced FRP will also give Ofgem additional regulatory tools to facilitate ongoing resilience and minimise mutualisation costs. In practice this will mean a requirement on supply licensees to inform Ofgem when they hit certain Trigger Points indicating potential financial issues and a requirement to complete an annual adequacy self-assessment.

We have also decided to proceed with requiring suppliers to ringfence Renewables Obligation (RO) receipts attributable to domestic supply for the 2023/24 RO scheme year onwards, based on the evidence of our analysis showing clear net benefits, and widespread stakeholder support. We will require suppliers to provide evidence of their having ringfenced their RO receipts for Quarters 1 and 2 of the 2023/24 scheme in Quarter 3 of the scheme year (November 2023) and each quarter thereafter. An amended Earnings Before Interest and Tax (EBIT) allowance in the price cap will reflect the additional working capital required to replace the RO receipts.

Further consultation

In the November statutory consultation we proposed to introduce a common minimum capital requirement for domestic suppliers. We recognised that the sector is currently under-capitalised and proposed a short-term target to be met by March 2025 with suppliers required to submit plans for how they would move towards the target. We also proposed definitions of alternative liabilities and contingent liabilities ("funding sources"), in addition to the value of equity, that could count towards the capital measure. Stakeholder feedback on this proposal was divided, with issues raised on measures, timing and definition of alternative funding sources. We are therefore taking the opportunity to allow further engagement and share our evolving thinking on target levels and our intended compliance approach.

Finally, we also proposed in the November statutory consultation to introduce the power to direct individual suppliers to ringfence Customer Credit Balances (CCBs) in specified circumstances. This recognised feedback from the policy consultation that imposing market-wide ringfencing of CCBs would be untargeted and impose costs on all suppliers, with our Impact Assessment showing a higher net benefit from a common minimum capital requirement and ringfencing of the RO than ringfencing CCBs and the RO. We continue to take the view that a targeted approach to the ringfencing of CCBs is the right one. However, we have modified our proposals in light of stakeholder feedback from the November statutory consultation, in which concerns were raised as to some of the circumstances in which the power to direct individual suppliers to ringfence CCBs could be triggered. Accordingly, we are taking the opportunity to seek further views to refine and design licence drafting with respect to CCB ringfencing. In particular, in the modified proposals that we are consulting on, the power to direct ringfencing of CCBs would be available in circumstances where a supplier does not maintain monthly cash balances at a level equal to or greater than 20% of gross credit CCBs, or where it cannot reach the Capital Target equivalent to £130 per dual fuel domestic customer (as appropriate).

Next steps

This further consultation on a common minimum capital requirement and introducing powers to ringfence CCBs is published alongside this decision document.

Introduction

Section summary

This section sets out the context of this Decision, alongside the previous policy and statutory consultation that have led to the introduction of the enhanced Financial Responsibility Principle (FRP) and ringfencing of Renewables Obligation (RO) receipts. Proposals on a common minimum capital requirement and introducing powers to ringfence Customer Credit Balances (CCBs) are subject to further consultation to gain further stakeholder views, published alongside this document. This section also details the structure and overall headings for the remainder of this Decision Document.

Subject of this decision

This document sets out our decision to proceed with the proposed introduction of the enhanced FRP and ringfencing of RO receipts that were subject to statutory consultation published 25 November 2022.

Other proposals detailed in that November consultation stage will be subject to a further consultation to inform finalisation of design of the common minimum capital requirement and the introduction of powers to direct the ringfencing CCBs policies.

Structure of this Decision Document

This document is split into 5 chapters:

- The introduction provides the context for this decision
- Chapter 1 sets out our proposals, stakeholder responses and Final Decision on the enhanced FRP
- Chapter 2 sets out our proposals, stakeholder responses and Final Decision on RO ringfencing
- Chapter 3 sets out our proposals, stakeholder responses and Final Decision on Protection Mechanisms
- Chapter 4 (appendix) sets out final notices and a link to consultation responses

Alongside this document we are publishing the following:

- Updated Impact Assessment and model
- Price cap annex 8 allowance model
- Electricity and gas decision notices for SLC 4B

- Electricity decision notice for SLC 30
- Updated FRP guidance
- Updated RO ringfencing guidance
- RO Ringfencing Schedule 2023/24

Context

The case for intervention

The events of recent years have demonstrated the challenges posed by extreme volatility affecting the retail energy market.

Since August 2021 30 suppliers exited the market through the Supplier of Last Resort (SoLR) or Special Administration Regime (SAR) mechanisms. This had direct consequences for almost 4 million consumers, primarily domestic customers, but has also come at a financial cost for all customers through the costs of failure being mutualised. The cost from SoLRs is currently estimated at £2.6bn[2], with the final impact uncertain. The final impact of the Bulb SAR will depend on wholesale prices and government decisions on cost-recovery. More generally, the mutualisation cost of any future exits is uncertain, depends on external factors, and can be very large without mitigation.

This scale of cost to consumers has been a focus for Ofgem and has rightly been subject to external scrutiny and required action to address. GEMA commissioned a report from economic consultancy Oxera to investigate what went wrong and deliver recommendations on where reform was required. Common characteristics identified by the report were that there was not enough capital held by failed suppliers to withstand market shocks, unsustainable pricing strategies, and poor hedging against financial risks.

In December 2021, Ofgem introduced a range of reforms to help deliver robust minimum standards, protect customer money and deliver accountability and control. We have:

- Introduced stress-testing to help assess whether suppliers are robust to a range of market scenarios.

[2] This figure is comprised of £2.3bn approved claims of SoLRs appointed since August 2021 (with some SoLR claims continuing to be processed), and £296m of RO and FiT payments since July 2021, which includes estimated RO 21-22 Mutualisation shortfall. This does not include the Bulb SAR, for which the Office for Budget Responsibility in its March 2023 Economic and Fiscal Outlook has provided further detail.

- Put in place stronger rules on calculating customer direct debits using the best and most current information.
- Requested assurance on suppliers’ management control frameworks for financial risk.
- Undertaken compliance and enforcement action under our current rules to address concerns identified by the stress-testing and assurance exercises.
- Strengthened Ofgem’s ability to intervene at milestone assessments.
- Provided further guidance on the financial risk controls and fit and proper person assessments, in licence entry checks.

The past year has also seen unprecedented wholesale price volatility as a result of international factors including the invasion of Ukraine. At their peak in August 2022, the weekly average Forward Delivery Contract price for gas was nearly £6 per therm[3], a nearly 700% increase on the same prices seen a year previously. This volatility has fed through to retail energy suppliers, contributing to the sector as a whole being loss-making for periods of time. While there is a balance to be struck in continuing to enable new-entry and innovation, we want these reforms to deliver well-capitalised businesses that can weather price fluctuations and avoid any repeat of the levels of failures and subsequent consumer costs we have seen in previous recent years.

Objectives of the policies

While progress has been made to improve the resilience of the sector, we recognise that gaps remain.

As recognised in the Oxera[4] report, key failings of the current market include ensuring suppliers have “skin in the game” to address the moral hazard and the low capitalisation of suppliers which makes them less able to withstand shocks. What this means in practice is that suppliers have been able to enter the market and rely on “free, risk-free" capital from sources such as customer credit balances and monies from pass-through costs such as the Renewables Obligation, presenting an opportunity to enter the market with a minimal amount of shareholder assets or capital at risk.

Moving to a model ensuring that business-owners have capital at risk will in turn reduce their incentive to take excessive risks, and the act of raising capital prior to entry or on

[3] Wholesale market indicators | Ofgem
[4] Review of Ofgem's regulation of the energy supply market | Oxera

an ongoing basis will further encourage scrutiny of business plans and ongoing ability to trade.

Ultimately, the objective of the package of measures is to ensure the recapitalisation of the sector, enhance resilience to external shocks and put the retail market on a solid foundation to deliver the innovation, high standards and consumer outcomes needed to achieve our principal objective to protect the interests of existing and future consumers.

Overview of November Statutory Consultation feedback

Stakeholder feedback to our November 2022 Statutory Consultation was mixed across the different elements of the package of policies we proposed:

- Almost all stakeholders recognised the need to address financial resilience in the sector. The enhanced Financial Responsibility Principle was broadly supported, with areas of feedback centring on Ofgem's ability to monitor and enforce the requirements. Some suppliers were concerned that the EFRP could represent over-reporting and that our triggers framework was set at too low a threshold.
- RO ringfencing also secured broad support on the necessity of the measure, with stakeholder views primarily divided on speed of implementation to ensure suppliers could put in place the necessary protection mechanisms.
- The common minimum capital requirement saw opinion divided among stakeholders on the definition of capital, the level of the common minimum capital requirement and the scope of alternative funding sources that could be used to meet the requirement.
- There was disappointment from some stakeholders that market-wide CCB ringfencing was not being taken forward, with feedback on the revised approach of taking powers to ringfence CCBs and a series of triggers centring on the design of some of these and when they would be used.

There were also more general feedback points on the process of the statutory consultation. While we note the process concerns raised, these proposals were well trailed in the June policy consultation and we have sought to engage with stakeholders in bilateral meetings and otherwise to ensure that we have fully considered their views before reaching our final decisions. Other documents including on RO ringfencing have been made available in recent weeks for informal input recognising suppliers need time to put measures into practice. Our updated impact assessment also includes a broader range of scenarios and sensitivities and greater commentary to address some of the challenges raised and demonstrate the net benefits of the proposals under a wide range of scenarios.

A consistent theme from many respondents was the need to consider these proposals in tandem with other areas of Ofgem policy-making, particularly the need to support the investability of the sector through reform of the EBIT allowance in the energy price cap. We recognise that capital requirements will require a profitable sector, and we will be taking that into account with our forthcoming decision on the EBIT allowance in the price cap. We have collaborated with the ongoing EBIT review process to understand the collective interactions and dependencies, and our revised impact assessment also continues to include sensitivity analysis to assess how far the price cap, financial frictions and our policies on asset control affect the net benefits. In each scenario our preferred option returns net benefits to the consumer.

Our decisions

Taking into account stakeholder feedback, we will be taking different approaches to different aspects of the policy package.

- We are implementing the enhanced FRP, following stakeholder support and illustration of the clear benefits of these proposals. The enhanced FRP will enable a change to the culture of risk reporting among suppliers such that it is more proactive and focused on remedies, as well as creating a clear framework for managing risks beyond the proposed common minimum capital requirement. Recognising the risk of duplicating existing information requests or adding undue burden, changes have been made to the detailed reporting requirements.
- We are implementing RO ringfencing, with analysis demonstrating the benefit of the proposal and widespread support from stakeholders. The requirement will be for suppliers to provide evidence of their having ringfenced their RO receipts for Quarters 1 and 2 of the 2023/24 scheme in Quarter 3 (November 2023) and for each quarter thereafter.
- We are consulting further on the common minimum capital requirement in response to stakeholder feedback that further detail and clarification was required on our proposals. We are seeking feedback in particular on the definition of capital, the level of the Capital Target equivalent to £130 Adjusted Net Assets per domestic dual fuel customer, and our proposed compliance approach of a Capital Floor of £0 per domestic customer from end March 2025, accompanied by transition controls where firms are above the Capital Floor but below the Capital Target.
- We are consulting further on the power to direct CCB ringfencing with revised licence drafting clarifying the circumstances in which we may use the direction. This consultation will enable further engagement on the design of some of these

triggers that could lead to the direction to ringfence, and detailed licence drafting to give effect to these.

Our decision-making process

Decision on the Supplier Licensing Review

In November 2020 through our Supplier Licensing Review[5] we introduced measures designed to promote more responsible risk management, improve governance and increase accountability, and enhance our market oversight of the retail energy sector. Interventions included the introduction of the Financial Responsibility Principle (FRP), which introduced an overarching obligation ensuring suppliers act in a more financially responsible manner and take steps to bear an appropriate share of their risk.

June 2022 Policy Consultation

Following market volatility and a high level of supplier exits, our December 2021 Action Plan[6] contained a package of measures designed to immediately boost financial resilience in the retail energy market. It also signalled our intent to consult on detailed policy options tackling mutualisation risks associated with Renewables Obligation receipts and Customer Credit Balances, and on a wider review of the regulatory framework for supplier financial resilience.

We consulted[7] in June 2022 on changes to improve retail supplier financial resilience and ensure that risks were not being inappropriately passed on to consumers. We proposed measures to protect customer credit balances and money collected to meet Renewables Obligation payments. We also proposed to introduce specific capital adequacy requirements for suppliers and sought initial proposals aimed at reducing the costs associated with hedging when a supplier fails.

November 2022 Statutory Consultation

Following the policy consultation, we consulted through our November statutory consultation[8] on our revised proposals to strengthen financial resilience in the retail energy market. We proposed to set a common minimum capital requirement for all domestic suppliers as well as ringfencing of RO receipts attributable to domestic supply. This is supported by an enhanced FRP and monitoring framework across all energy

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[5] Decision on the Supplier Licensing Review: Ongoing requirements and exit arrangements | Ofgem
[6] Action plan on retail financial resilience | Ofgem
[7] Policy Consultation: Strengthening Financial Resilience | Ofgem
[8] Statutory Consultation - Strengthening Financial Resilience | Ofgem

suppliers. We decided at this stage not to proceed with the market-wide ringfencing of customers' credit balances, but instead proposed to set a monitoring threshold to avoid suppliers overly relying on these funds and to introduce powers to direct individual domestic suppliers to ringfence CCBs when they are at risk of not meeting set financial standards. We recognised that a monitoring threshold approach would be better targeted against risk and would not therefore impose costs on efficient suppliers – which we considered to be in the best interests of consumers. The approach to CCBs was necessarily different to RO ringfencing, since for ROs there is a clear 'pass through' arrangement intended solely to fund a government renewables scheme which could easily circumvent suppliers altogether were the scheme designed in a different way.

Public sector equality duty

As a public body, Ofgem is subject to the requirements of the public sector equality duty, as set out in section 149 of Equality Act 2010 (PSED). This means we must look for ways to eliminate discrimination, advance equality of opportunity and foster good relations between people who share protected characteristics, and those who do not.

In our equality, diversity and inclusion strategy we state: "As the regulator of the energy sector, we recognise the real-life impact of the work that we do and the decisions we make." In this decision, we have had due regard to the impact on vulnerable consumers. As we describe in the Impact Assessment published alongside this document, our intervention should mean greater savings for disengaged customers (those less likely to switch), who are slightly more likely to be in vulnerable circumstances, than engaged customers. This is reflected in the distributional weights published in the Impact Assessment.

Through this decision, vulnerable consumers will in effect transfer less money to the customers of failed suppliers to cover mutualised costs associated with credit balances and renewables obligations, and they will generally transfer less to the customers of failed suppliers to cover differences between wholesale prices and allowances under the price cap, due to the lower frequency of default. We believe these benefits outweigh the slightly higher prices that engaged consumers may face due to decreased incentives for suppliers to offer unsustainably low prices based on subsidised capital.

General feedback

We believe that consultation is at the heart of good policy development. We are keen to receive your comments about this decision document. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall quality of this document?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Are its conclusions balanced?
5. Did it make reasoned recommendations?
6. Any further comments

Please send any general feedback comments to stakeholders@ofgem.gov.uk

1. Enhanced Financial Responsibility Principle

Section summary

In this chapter we summarise what was consulted on in November and our decision to proceed with implementation. We proposed enhancing the Financial Responsibility Principle (FRP) to clarify the financial resilience requirements for suppliers and to change the culture of risk reporting, such that it is more proactive and focused on risk mitigation. The main changes we proposed included broadening the focus of the FRP, introducing a triggers framework, as well as a requirement for an Annual Adequacy Self-Assessment. Most stakeholders supported our proposals and the principle of more proactive risk management, however there were some concerns that the principle relied too heavily on self-reporting, that the reporting burden was too much and unaligned with other reporting requirements, and that there was not sufficient clarity in the triggers framework.

We have taken a decision to implement the enhanced FRP that we consulted on but, in response to stakeholder feedback, we have made some changes. Most notably, these changes are centred around refining and providing more clarity on the triggers framework and Annual Adequacy Self-Assessment. It is also worth noting that some aspects of the proposed enhanced FRP will be further iterated through consultation, such as those aspects to do with the common minimum capital requirement and customer credit balances (CCBs).

What we consulted on

1.1 We proposed enhancing the Financial Responsibility Principle (FRP) to clarify the financial resilience requirements of suppliers and to change the culture of risk reporting, such that it is more proactive and focused on risk mitigation. Where a common minimum capital requirement would set a market-wide minimum for improving suppliers' resilience, the enhanced FRP would require suppliers to maintain sufficient capital, liquidity and risk management strategies to manage business specific risk.

1.2 The current FRP requires suppliers to manage responsibly, at all times, the costs that could be mutualised and take appropriate action to minimise such costs. Guidance sets out that this means demonstrating – among other things – sustainable pricing approaches to cover costs over time, and that risks of any pricing approach sit with investors and not consumers; robust financial governance and decision-making frameworks; and the ability to meet financial obligations while not being overly reliant on customer credit balances (CCBs) for working capital.

1.3 The principle is an effective tool and Ofgem can and does enforce responsible financial management under the existing FRP. However, the FRP can be enhanced by setting more explicit financial resilience and responsibility requirements for suppliers.

1.4 As such, we proposed making it a requirement for suppliers to maintain sufficient capital and liquidity to ensure they can meet their reasonably anticipated liabilities as they fall due. We initially proposed that this would complement a 'Pillar 1' minimum capital requirement (the details of which are subject to further consultation, as outlined in the sections below), by building on this market-wide minimum standard to require that a supplier would be able to manage its business specific risks. Proposed 'Pillar 2' elements – under the enhanced FRP – required that suppliers would be expected to understand and mitigate their business-specific risks to ensure they have sufficient capital and liquidity to remain resilient in severe but plausible stress scenarios. Supplier self-assessment reporting regarding business-specific risks (combined with ongoing Ofgem monitoring) was proposed to help Ofgem understand if further interventions would be needed to maintain this required level of resilience.

1.5 We made clear that the proposals for the enhanced FRP would apply to both domestic and non-domestic suppliers, save for the specific elements that relate to the common minimum capital requirement and directing ringfencing of CCBs. We proposed that our monitoring approach for non-domestic suppliers would be proportionate to the risk of mutualisation.

1.6 These proposals responded to feedback from the June policy consultation, which encouraged the design of a proportionate framework targeted at business specific risks, that allowed for early intervention, acknowledged the broader suite of financial monitoring required by Ofgem and other regulators (e.g., Going Concern Requirements), and considered existing internal financial and management controls. The main gaps identified in the existing FRP were centred around a need for:

- Clearer expectations of suppliers regarding ongoing financial resilience obligations;
- More proactive financial regulatory reporting and response;
- Enhanced monitoring of reliance on CCBs, and

- Clearer expectations about financial regulatory reporting and monitoring (i.e., ensuring that it is proportionate and reflects the wider financial monitoring required by Ofgem and other regulators, as well as internal processes).

1.7 As such, our proposals centred around introducing the following aspects.

Clarifying and broadening the focus of the FRP

1.8 We thought the FRP could be enhanced by setting clearer expectations of the ongoing financial resilience of suppliers. To do so, we proposed clearer and broader obligations, requiring suppliers to maintain sufficient resources to ensure they can meet their reasonably anticipated liabilities, as well as responsibly managing and minimising costs at risk of mutualisation.

1.9 We proposed broadening the focus of the FRP to require that licensees must:

- Ensure they maintain sufficient capital and liquidity so they can meet their reasonably anticipated liabilities as they fall due on an ongoing basis. This was proposed to include maintaining a common minimum capital requirement (details subject to further consultation).
- Ensure that, were they to exit the market, the exit would be orderly. We initially explained that this would mean the supplier has to ensure its operational and financial arrangements are such that any Supplier of Last Resort (SoLR) or special administrator would be able to effectively and efficiently serve its customers, and that the exit would not result in material mutualised costs.

1.10 We proposed this change to set clear expectations for a supplier’s ongoing management of their business specific risks. It was also intended to provide clearer expectations for the Pillar 2 financial reporting and monitoring framework which Ofgem would use to understand suppliers’ actual resilience and the need for further intervention or capital beyond the common minimum capital requirement. It bolsters our expectations that suppliers responsibly manage their potential mutualisation costs and requires, should suppliers exit the market, that disruption to customers and the market will be minimised.

Triggers Framework

1.11 We also thought that the FRP could be strengthened by having more proactive financial reporting and response. As such, we proposed additional reporting requirements to capture existing and emerging business-specific risks. We set out the detail in the draft FRP guidance, which included details of an annual self-assessment reporting framework on capital adequacy and risk management (outlined in the section below), as well as specific Trigger Points to act as indicators of (early) financial stress.

1.12 These proposals included requirements on suppliers to proactively report to Ofgem regarding how they are meeting requirements for ongoing financial resilience and to flag where risks arise. This included the requirement for suppliers to evaluate and report on their business specific risks and mitigations throughout the reporting period, ensuring they have sufficient capital and liquidity on an ongoing basis to meet their financial liabilities in the context of severe but plausible stresses. We also proposed more opportunities for early intervention and targeted responses.

1.13 These proposals responded to feedback from the June policy consultation, which encouraged the design of a proportionate framework targeted at business specific risks, that allowed for early intervention, acknowledged the broader suite of financial monitoring required by Ofgem and other regulators (e.g., Going Concern Requirements), and considered existing internal financial and management controls.

1.14 The triggers framework was proposed as a proactive reporting requirement, where a supplier must notify Ofgem when it becomes aware it may not be able to hold the common minimum capital requirement or if any of the Trigger Points are hit/expected to be hit. It was also proposed that the triggers framework would be used for enhanced monitoring of reliance on CCBs. This was intended to make it easier for Ofgem to intervene (e.g., through engagement, enhanced monitoring, requesting an independent audit, direction to protect CCBs, or enforcement action to ensure compliance with the FRP) where we may be concerned about the financial situation of suppliers and increase the likelihood that the impacts of any financial stress can be caught early. The proposals were also intended to provide further clarity on the circumstances under which we would expect to be notified where arrangements change between reporting periods.

Annual Adequacy Self-Assessment

1.15 We also proposed the introduction of an annual requirement on suppliers to submit a self-assessment of their business model, risks and mitigations over the previous 12 months and the coming year, evidencing how they are compliant with the enhanced FRP. This was intended to be proportionate, both in terms of the administrative burden on suppliers – given we would expect them to use outputs from existing internal analysis – and also in terms of our response, as it would allow us to understand the specific situation of each supplier.

Stakeholder responses

Enforcement, risk management reporting and compliance

1.16 Most stakeholders supported our proposals and the principle of more proactive risk management. Respondents broadly agreed that our enhanced FRP proposals were important for ensuring suppliers have sufficient capital to meet their business specific needs. However, we received feedback on the proportionality and operational capacity of our proposed regulatory approach from some respondents. There were views that the enforcement proposals relied on a discretionary approach and supplier self-assessment, with concern some may only provide the absolute minimum monitoring data required. Stakeholders felt Ofgem will need improved resourcing for reacting to and processing enhanced FRP data while ensuring adequate enforcement workstreams to streamline requests to suppliers and keep supplier compliance costs to a minimum.

Duplication of data through Reporting Requirements

1.17 A minority of stakeholders did not agree with our approach. They advised that the enhanced FRP could instead be made more proportionate to each supplier's respective risk. Despite overall agreement with our approach, a few suppliers pointed out similarities in the Annual Adequacy Self-Assessment to the Going Concern Assessments that company directors undertake as part of annual audit processes. These suppliers proposed that these similarities should be explored to understand how requirements can be reviewed to minimise any data duplication and unnecessary costs for suppliers.

1.18 In addition to duplication concerns, there was some concern regarding the amount of data suppliers are already required to report to Ofgem and that further information requests may be burdensome to the effective running of an organisation. One supplier suggested that the proposals are disjointed, and that the enhanced FRP does not seem to fit into a coherent framework.

Interaction with Common Minimum Capital Requirement

1.19 A minority of suppliers suggested that the enhanced FRP and common minimum capital requirement should interact to reduce the capital requirement on firms who can demonstrate reductions in residual risk to their businesses. There was also a suggestion that Ofgem may wish to request an internal audit and only deploy independent, external audits in extreme circumstances. The majority of suppliers recommended that Ofgem clarify and deploy a reasonably practicable timeframe for suppliers to notify Ofgem if they breached the capital requirement and to further clarify the circumstances in which a reporting trigger would be required.

Triggers process and framework

1.20 Several suppliers believed there could be more clarity around levels of materiality that would require a Trigger Point notification. A few suppliers also further raised the issue that Ofgem has not made clear how the enhanced FRP fits in with other monitoring requirements such as monthly Requests for Information (RFIs) and stress-testing. One supplier felt further explanation should be given by Ofgem which outlines our overall vision and framework, and to explain how each requirement fits in with one another. It is worth highlighting, however, that a majority of suppliers felt that the triggers process and framework could be utilised to strengthen financial resilience and protect consumer interests. It was felt that a refinement and clarification of the process and framework will ensure suppliers can monitor and deliver their financial obligations appropriately and efficiently, though Ofgem will also need to consider the 'success' of the policy, in full, and not await any potential supplier failures to determine such success.

Market exits

1.21 A small number of suppliers commented on the enhanced FRP's impact, with the majority of these comments highlighting that the proposals bring down the risk that financial liabilities cannot be met, which ultimately reduces the likelihood of a costly and disorganised market exit. However, one response stated that the benefits of the proposed SLC 4B.2[9] were unclear. The concerned supplier thought that this requirement is already covered by obligations to have sufficient capital and liquidity, to own material assets and to maintain a Customer Supply Continuity Plan. This supplier also felt that this standard condition potentially contradicted Ofgem's position on other proposals in our consultation, underlying the risks associated with using principles-based regulation to implement minimum financial standards.

[9] The proposed SLC 4B.2 was *"The licensee must ensure that, were it to exit the supply market (due to insolvency, licence revocation or in any other circumstances), said exit would be an Orderly Market Exit."*

Resourcing

1.22 In tandem with the wider stakeholder support for our proposal of packages, stakeholders also thought that the success of our outlined approach is contingent on Ofgem demonstrating that it has and will continuously and adequately resource the monitoring and enforcement of the enhanced FRP. This is also reflective of the above-mentioned view whereby the success of the policy packages comes down to Ofgem's proactive monitoring and enforcement when implementing proposals, as much as the response to any supplier failures or market exits.

Decision

1.23 We are taking a decision to implement the enhanced FRP broadly as we consulted on in November but, in response to stakeholder feedback, we are making some changes to the licence and Guidance:

- **Broadening the focus of the FRP**: we are proceeding as set out in consultation to broaden the focus of the FRP, but we are making some clarificatory changes to the drafting of the licence condition, including removing references to the common minimum capital requirement pending the outcome of the latest statutory consultation.
- **Triggers framework**: we are proceeding with the triggers framework, but we are providing further clarity on the Trigger Points, reducing the number of Trigger Points, and clarifying that complying with them is a requirement by putting them in the licence. We are also consulting further on the details of the CCB trigger.
- **Annual Adequacy Self-Assessment:** we are proceeding as set out in the consultation but clarifying that this is a requirement by putting it into the licence. We have also provided clarity on the self-reporting process.

Broadening the focus of the FRP

1.24 We are proceeding with broadening the focus of the FRP to require suppliers to have sufficient capital and liquidity to meet reasonably anticipated liabilities as they fall due. We are also minded to proceed with setting a minimum for the loss absorbing capital required by suppliers but the details of this are subject to further consultation.

1.25 We have also made some clarificatory changes to the licence condition to make it clearer what is expected of a supplier in the event of market exit. In November we proposed broadening the focus of the FRP to require that the licensee must ensure that, were it to exit the supply market (due to insolvency, licence revocation or in any other circumstance), said exit would be an 'Orderly Market Exit'. We proposed defining an 'Orderly Market Exit' as one where a supplier ensures 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 the exit would not result in Material mutualised costs. Whilst we continue to think that these outcomes should be achieved when a supplier exits the market, having considered further we do not think that the SoLR or SAR process should be referred to explicitly as 'orderly'. This is because, whilst these processes are designed to protect consumers, they are still last resort options that will incur costs and cause some detriment to consumers.

1.26 In light of this, we have decided to refer directly to these outcomes in the licence conditions rather than the term 'Orderly Market Exit'. This makes it clearer that suppliers need to ensure that were they to exit the supply market (due to insolvency, licence revocation or in any other circumstance), their operational and financial arrangements are such that any SoLR or special administrator appointed would be able to efficiently and effectively serve their customers, and that the exit would result in minimised mutualised costs.

1.27 One stakeholder also raised the point that these outcomes should already be ensured by the existing FRP and Operational Capability Principle (OCP) requirements, as well as the ongoing requirement for suppliers to have a Customer Supply Continuity Plan. However, we have decided to keep this proposed standard condition, as well as reinstate the proposed omission of SLC 4B.2 (now 4B.4) regarding having at all times adequate financial arrangements in place to meet costs at risk of being Mutualised, in order to make obligations as clear as possible for suppliers.

Triggers framework

1.28 Many suppliers expressed concern that the triggers framework was unclear, that the Trigger Points were not targeted at the right level of risk, and therefore that it was difficult for suppliers to mitigate their regulatory risk. While we do not want to negatively impact suppliers' ability to operate effectively in the market, it is also incumbent on suppliers to manage their regulatory obligations. We are therefore proceeding with the triggers framework but making the following changes to address stakeholder feedback:

- We have clarified the Trigger Points and moved them from the Guidance into the license itself.
- We have adjusted the language and rationalised the Trigger Points to better reflect the level and type of risk at which we expect to be notified.
- Our approach to responding to a trigger notification has been clarified in the Guidance.

1.29 Our policy intent is that this new reporting framework, including the Trigger Points and self-assessment reporting, will be part of a culture shift of risk management and reporting in the retail market. It will do this by placing the onus on suppliers to identify issues early (including through the Trigger Points), and to embed continuous improvement over time by setting out their business plan, risks, and mitigations in their Annual Adequacy Self-Assessment. These arrangements are missing from the current regime, and we think they will help to build supplier resilience by highlighting the importance of risk management and governance alongside a common minimum capital requirement (subject to further consultation).

1.30 To achieve this policy outcome, the Trigger Points are designed to require suppliers to report at points where changes in their business have, or will have, an impact on their ability to meet their obligations under the enhanced FRP. Supplier obligations under the enhanced FRP include, among other things, meeting their liabilities as they fall due. Trigger Points are intended to act as an early warning where suppliers are, or anticipate that they may be, in a position where they are unable to meet their obligations under the enhanced FRP.

1.31 To clarify the nature of the requirement on licensees to notify Ofgem when a Trigger Point is hit, we have added the list of Trigger Points to the licence condition. We think that, by creating a list of individual Trigger Points in the SLC and including more detail on notification expectations in the Guidance, we have clarified for suppliers that the notification requirement is an obligation which has been set at a reasonable threshold.

1.32 We acknowledge that, in the November statutory consultation, it was unclear whether the Guidance was intended to be mandatory. We have amended the wording of the Guidance and the licence conditions to make clear that the Guidance is clarificatory – it is intended to further explain and clarify the obligations contained in the licence conditions. In particular, we have removed the proposed standard conditions which indicated that the Guidance was mandatory, and we have also made changes to the language used in some parts of the proposed Guidance to make a clear distinction between what is an enforceable obligation and what is an expectation. Aspects of the Guidance consulted upon which we do consider licensees must comply with (such as the Trigger Points and the Annual Adequacy Self-Assessment) have been moved into the licence condition itself and the Guidance document as it stands is clarificatory. Failure to follow the Guidance may, however, be evidence of a breach of the relevant licence conditions.

Clarifying the level and type of risk threshold for Trigger Points

1.33 We received feedback from suppliers that there were too many Trigger Points to report on and that they were not targeted at the appropriate level of risk. Some suppliers also mentioned that the Trigger Points overlapped with existing reporting requirements and that there was unnecessary duplication.

1.34 The key purpose of the triggers framework is for suppliers to ensure they can be aware of and proactively notify Ofgem of business specific risks early enough so that they – or Ofgem – can take quick remedial action wherever possible and in sufficient time.

1.35 We therefore looked at our reporting and monitoring in the round to ensure that our requirements are proportionate and add value. The rationale for our decision on the Trigger Points is set out in Table 1. The table makes clear that for information regarding suppliers' funding circumstances (e.g., Access to Funds and their contractual arrangements with counterparties), it is important for Ofgem to be made aware of any change that may impact their ability to meet the enhanced FRP as early as possible – and on an intramonth basis if needed – in order to intervene where necessary. For Trigger Points related to specific numerical data points, such as those related to profit/loss, revenue, liquidity and hedging, we consider that ongoing reporting requirements are sufficient and provide enough detail. We have therefore rationalised the proposed list of triggers and clarified the level and type of risk threshold as a result, moving forward with only three:

- Any reduction in the licensee's Access to Funds, where this may impact the licensee's ability to meet the enhanced FRP;
- Any changes with respect to the licensee's contractual arrangements with counterparties, where this may impact the licensee's ability to meet the enhanced FRP, and
- Any change that could have a Material adverse effect in respect to the cash position of the licensee.

Table 1: Rationale underpinning decision on triggers

Financial indicator / proposed trigger	Request for Information	Stress Test	Reporting Gaps	Proceed with Trigger Point?
Access to Funds	✓	✓	Ofgem requires more granular (i.e., intramonth) notifications.	Yes – Ofgem to be notified of any reduction in the licensee's Access to Funds.
Arrangements with counterparties	(no scenario attached to it)	✓	Ofgem requires more granular (i.e., intramonth) notifications.	Yes – Ofgem to be notified of any changes with respect to the licensee's contractual arrangements with counterparties.
Net Assets / Liabilities	✓	✓	Ofgem requires more granular (i.e., intramonth) notification.	In part – Suppliers may not know their intramonth net assets position so instead Ofgem to be notified of any change that could have a Material adverse effect in respect to the cash position of the licensee.
Profit/loss, revenue & liquidity		✓		No - Sufficiently covered by cash position trigger and ongoing requirements.
Hedging	✓	✓		No - Hedging positions change regularly and we receive sufficient data from the monthly RFI and stress tests.
CCBs	✓	✓	Reliance on CCBs, more granular (i.e., intramonth) reporting.	Proposed trigger but removed – pending further consultation.

1.36 While we agree that there were too many Trigger Points initially proposed and that the reporting threshold as proposed was too sensitive, we believe that the reporting threshold for these remaining Trigger Points is set at the right level, as these are important indicators of financial resilience. To be clear, for the first two Trigger Points, Ofgem should be notified of any reduction / changes if the change impacts or is anticipated to impact a supplier's ability to meet their requirements under the enhanced FRP. For the third Trigger Point on the cash position of the licensee, Ofgem should be notified of any change which will have a Material adverse effect.

1.37 To provide further clarity on what we expect from suppliers, and to be clearer about the level and type of risk threshold for the Trigger Points, we have provided examples in the Guidance of what we mean by these Trigger Points and when we would expect to be notified.

Ofgem's response to a trigger notification

1.38 To provide clarity for suppliers on Ofgem's general expectations and approach to Trigger Point notifications, to assist suppliers' own planning and responses, we have put in the Guidance some potential examples of how Ofgem may respond to Trigger Point notifications. These will vary based on circumstance, but might include, for example, enhanced monitoring or requesting that the supplier cease making non-essential payments. We have also made it clear that the potential actions or responses outlined do not prevent us from taking alternative or additional actions in appropriate cases, for example in some circumstances we may move straight to enforcement action. Overall, we want to be able to work with suppliers to take appropriate action, as our intention is to achieve the best outcome for consumers.

1.39 Some further clarificatory changes have also been made to make it clear to suppliers how Ofgem will respond to Trigger Point notifications. Firstly, we have introduced a requirement to notify Ofgem as soon as reasonably practicable but no later than 7 days after a supplier becomes aware that there is a Material risk that any of the Trigger Points will occur, or that any of the Trigger Points have occurred. As the triggers framework is supposed to help identify early signs of financial instability, this deadline has been introduced to ensure that Ofgem is notified early enough to intervene if necessary.

1.40 In addition, in order to prevent suppliers from being obliged to continuously notify Ofgem 28 days before making any payment, providing any loan or transferring any asset to any third party (unless it is essential) once a Trigger Point has been hit (SLC 4B.7), we have decided to make clear that suppliers must only continue to do so until Ofgem has confirmed that such notification is no longer required. We have also made clear in the Guidance that, for the avoidance of doubt, this standard condition does not prevent any existing arrangements which would decrease costs for consumers, such as cash efficiency measures (which includes arrangements where the supplier loans excess cash back on a short-term basis to the centre/group treasury to manage).

CCB Trigger

1.41 Whilst we are committed to using the triggers framework for the enhanced monitoring of CCBs, we are consulting further on the details of the CCB specific Trigger Point as well as the decision-making process for the decision to direct CCB ringfencing and the proportion of CCBs that a supplier would be directed to ringfence.

Annual Adequacy Self-Assessment

1.42 As mentioned with regards to the Trigger Points, some suppliers were concerned that our Annual Adequacy Self-Assessment reporting requirement represented over-reporting and that there was too much overlap with other reporting requirements, including licence conditions requiring suppliers to be open with Ofgem (SLC 5A) and to notify us of any relevant commercial changes (SLC 19AA) (e.g., a trade sale or relevant merger, changes in senior personnel and other business-impacting matters, as well as requirements around control of assets and operational capability). Whilst we have refrained from introducing some aspects of the proposals into the licence (e.g., requiring an update following a significant change in the suppliers business or operating model – this is due to overlap with SLC 19AA), we have considered our reporting requests in the round and remain persuaded that our Annual Adequacy Self-Assessment requirement is sufficiently different to existing requirements and that it adds real value to strengthening financial resilience (see Table 2).

1.43 As the table below shows, there is a clear gap in the ongoing monitoring of supplier financial resilience that can be closed through annual self-assessment reporting and we are therefore proceeding with the broad proposals we consulted on for the Annual Adequacy Self-Assessment. The table also shows that the Annual Adequacy Self-Assessment report will better enable Ofgem to analyse and assess the efficacy of supplier arrangements to manage risk over a longer period, with the intention to embed continuous improvement in supplier reporting over time. Suppliers are expected to set out how they manage their business specific risks, including how they have appropriate capital and liquidity to address this. In providing us with this analysis, we will be able to assess this information and potentially challenge it, particularly if we think the supplier has poor governance frameworks, poor risk management, or has displayed poor practice in previous submissions. In providing this information and insight, we will be able to best protect the interests of consumers by acting early wherever possible to mitigate risk and take enforcement action if required.

Table 2: Rationale underpinning decision to proceed with Annual Adequacy Self-Assessment to fill gaps in existing measures

			EFRP proposals				*Not ongoing requirements*			
Categories of information to assess resilience	**RAG with EFRP proposals**	**RAG w/o EFRP proposals**	**Triggers**	**Self-assessment**	**Request for Information**	**Stress testing**	**Management control framework**	**Supply licence application**	**Milestone assessment**	**Market Compliance Review**
Business objectives of supplier	Green	Amber		✓		✓ (12 month forecast)	✓	✓	✓	
Self-assessed compliance	Green	Amber		✓			✓	✓	✓	
Risk appetite	Green	Amber		✓			✓	✓		
Supplier business financing	Green	Amber	✓ (in part)	✓	✓ (not on reliability and quality)	✓ (not on reliability and quality)		✓ (not on reliability and quality)	✓ (not on reliability and quality)	
Financial and operational risks to achieving business objectives	Green	Amber		✓	✓ (limited information relating to operational risks only)	✓ (captures financial and operational risks in regulatory scenarios)	✓		✓	

Categories of information to assess resilience	RAG with EFRP proposals	RAG w/o EFRP proposals	Triggers	Self-assessment	Request for Information	Stress testing	Management control framework	Supply licence application	Milestone assessment	Market Compliance Review
Level of risk supplier can withstand before it cannot achieve objectives	Green	Red		✓		✓ (do not capture business model/plan-specific risks)		✓ (stress-tested business plans assessed at application)		
Remedies	Green	Red		✓						✓
Asset control	Green	Red		✓		✓	✓			✓
Governance, risk management and accountability	Green	Red		✓		(board sign off required for stress test only)				

1.44 We recognise that we have increased reporting requirements in response to recent market shocks, which is why we chose to introduce a low frequency, high detail reporting requirement. We already require new market entrants to set out their business/growth strategies, risk appetite, and how they are capitalised to achieve key outcomes and mitigate risks. This analysis is central to the capital adequacy regime and is work that can only be done by suppliers themselves. Table 2 also shows that the expectation in the Annual Adequacy Self-Assessment that suppliers report on their risk mitigation and remedies closes a gap that exists in our current reporting regime. Moving to this model of reporting is intended to shift the culture of reporting to one that places more responsibility on suppliers to assess their business-specific risks, the effectiveness of their mitigations, and their internal improvements.

1.45 Suppliers are best placed to understand their own risks and the best ways to manage them. Table 2 shows that there is a gap in our current requirements for suppliers to provide more long-term qualitative analysis on their business specific risks and mitigations, and opportunities to improve. As the self-assessment reporting goes beyond our existing monitoring activities, we have established it as an additional requirement to supplement the existing stress-testing and RFI regime, which is the enhanced monitoring and oversight function which collects regular financial data from suppliers.

1.46 We have sought to be proportionate, and where possible based our requirements on our understanding of suppliers' internal processes. We expect that, in most cases, suppliers will already be doing the majority of what we expect them to report on. We expect that suppliers will want to use existing processes and documentation to evidence they meet our expectations, and this was reflected in their written responses (and in some bilateral meetings). The language in the Guidance will not preclude suppliers from using their own reporting in their assessment.

Self-reporting process

1.47 Some suppliers queried the reporting process and asked whether we would set a specific date for the reports or allow suppliers to report in line with their own reporting cycles. We have considered this and are proposing a slight change to the consultation position in response to this feedback.

1.48 Suppliers have different end of year reporting dates and have a range of existing internal and external reporting requirements. We need to be aware of supplier reporting timetables and resourcing requirements (as well as our own) when considering how we want to establish the new reporting regime for the enhanced FRP. We recognise that suppliers report across different cycles across the year. We used Companies House data to check supplier annual reporting timetables, which are relatively evenly distributed throughout the year.

1.49 To minimise the administrative burden on suppliers, we are allowing suppliers to choose the date they submit the report so that it can align with their existing reporting cycles, as long as Ofgem receives an assessment at least every 12 calendar months. We are requiring that suppliers must submit their first Annual Adequacy Self-Assessment on a date of their choosing but no later than 31 March 2024. Suppliers must, within 28 days of the licence condition coming into effect, notify us of the date they will submit their self-assessment based on their internal reporting cycle. We will set out in Guidance the criteria we expect suppliers to meet when notifying us of their submission date.

1.50 We do not think a single reporting date would be appropriate, as suppliers internal reporting cycles operate differently. Setting a single reporting date may disadvantage some suppliers or result in incomplete or overextended reporting cycles. Allowing suppliers to submit based on their internal reporting cycles is a way to capture supplier reporting models and manage pressure on internal resourcing.

Next steps

Increasing our resources

1.51 Some stakeholders suggested that Ofgem would need improved resourcing for reacting to and processing enhanced FRP data while ensuring adequate enforcement workstreams to streamline requests to suppliers and keep supplier compliance costs to a minimum. In response to this, Ofgem has set up a new Financial Resilience and Controls (FRC) directorate and is allocating resources to manage these regulatory changes.

Further consultation

1.52 Some elements of the enhanced FRP licence condition that we consulted on in November will be subject to further consultation and are not included in our final decision at this time. These parts are those related to a) the common minimum capital requirement and b) ringfencing of CCBs.

1.53 In the updated licence conditions published alongside this decision, we have therefore removed those proposed sections (and the related definitions) which make specific reference to the common minimum capital requirement and ringfencing of CCBs. This includes whole sections, but also sub-sections or individual lines. These amendments to the licence condition are also subject to further consultation.

1.54 Similar changes have also been made in the Guidance. We have updated the Trigger Points and set out how Ofgem will respond more clearly, in addition to removing aspects related to the common minimum capital requirement and ringfencing of CCBs.

1.55 In line with stakeholder feedback, we will also ensure that we closely monitor the new reporting requirements that are being introduced to ensure that the framework is practical, proportionate and working in the best interests of consumers. As such, the monitoring framework may be reviewed and iterated to ensure there are no unintended consequences.

2. Ringfencing of RO receipts

Section summary

In this chapter we summarise what we consulted on in November in relation to ringfencing of Renewables Obligation (RO) receipts, stakeholder feedback and what we have decided to implement. We have decided to proceed with market-wide ringfencing of RO attributable to domestic supply for scheme year 2023/24. Suppliers will be required to ringfence their RO attributable to domestic supply for Q1 (Apr-Jun) and Q2 (Jul-Sep) jointly in Q3. This represents an important component of our wider strategy for improving suppliers' financial resilience.

What we consulted on

2.1 We proposed that a combined package of capital adequacy and ringfencing of Renewables Obligation (RO) receipts attributable to domestic electricity supply volumes would have the greatest long-term benefits for consumers. This was supported by our impact assessment[10] which showed that this approach has the highest annual benefit run-rate by 2028 (£326m per year compared to £286m for only capital adequacy). We continue to believe that government legislating for more regular payment of RO receipts would be the optimal solution to address misuse of RO receipts by suppliers. In the absence of such legislation, we consider that ringfencing is an appropriate and proportionate approach to tackling a long-standing issue that has contributed to the 'moral hazard' we have identified and added to mutualisation costs where suppliers have failed.

2.2 Aligned to the majority view of stakeholders, we proposed proceeding with an obligation that may be discharged through purchasing Renewables Obligation Certificates (ROCs), protecting funds equivalent to their liability in a RO Credit Cover Mechanism, or a combination of the two, on a quarterly basis. This offers suppliers flexibility and continues to preserve the tradeable nature of the ROC market which supports renewable generation. We proposed not proceeding with creating a trust over the proceeds of the sale of ROCs, and not proceeding with an interim reporting requirement.

1.1 We proposed a backward-facing approach for RO ringfencing because this means ringfencing requirements would be more accurate compared to forecasting. Not relying on predictions increases the precision of the proposals. In addition to

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[10] Revised impact assessment of Strengthening Financial Resilience proposals | Ofgem

eliminating the risk of over- or under-ringfencing, this approach also removes the need for any periodic reconciliation. A further benefit is that a backward-facing approach aligns with that taken under the Feed-in Tariffs (FiT) scheme and so will ease administration for both us and suppliers.

2.3 We proposed the introduction of RO ringfencing from 1 April 2023 to coincide with the start of the 2023/24 RO obligation period ('scheme year'). We considered that clearly signalling our intent in the recent statutory consultation allows suppliers sufficient time to initiate commercial arrangements to secure appropriate Protection Mechanisms and any other arrangements needed to successfully implement RO ringfencing.

2.4 We did not find a strong benefits case for extending ringfencing to non-domestic electricity supply volumes.

2.5 We understood suppliers could face additional costs when ringfencing the RO, which they may not be able to recover under the price cap. To this end we proposed an adjustment allowance, set out in Appendix 1 of the statutory consultation, to allow suppliers to recover costs associated with ringfencing RO receipts.

Supplementary consultation on draft supporting documents

2.6 On 3 March 2023 we published a suite of draft documents intended to support the operationalisation of the new requirements for RO ringfencing. These were:

- **Draft RO ringfencing schedule** – this set out the key dates and deadlines for the RO ringfencing process for the RO scheme year running from 1 April 2023 – 31 March 2024.
- **Draft Supplier guidance for Standard Licence Condition (SLC) 30 'Ringfencing the Renewables Obligation'** – this gave an overview of supplier obligations under draft standard licence condition 30 of the standard conditions of the electricity supply licence. The guidance explains what licensed electricity suppliers would be required to do to ringfence their RO. It sets out how we calculate the Quarterly Cumulative Obligation (QCO) as well as when and how proof of ringfencing would need to be evidenced.
- **Draft templates for the Protection Mechanisms** – these draft templates cover the Standby Letter of Credit, the First Demand Guarantee, the terms for a Trust Account, and the terms for an Escrow Account as referenced in 5.15 of the November statutory consultation. They are intended to be used to standardise the approach to ringfencing RO receipts and streamline administration for both suppliers and Ofgem.

Summary of responses

2.7 Most stakeholder responses supported Ofgem's proposals to ringfence RO from the 2023/24 scheme year onwards. Concerns generally focused on operational questions such as the 2.5 month delay in ROC issuance which could reduce availability for quarterly ringfencing and the risk that suppliers could sell ROCs after the closing of the compliance window. Suppliers also asked to see the RO ringfencing timetable as soon as possible to help financial planning. Objections to the proposals generally focused on the impact ringfencing would have on supplier cash flow, and that the adjustment allowance proposed in Appendix 1 would be insufficient to meet their costs. A small number of respondents asked that we explore an implementation deferral to allow for suppliers to adjust accordingly.

Ringfencing 100% of RO domestic supply from 2023/24

2.8 Of respondents who provided a view, a majority explicitly supported immediate implementation. Although not all respondents elaborated on their rationale for agreement, those that did, supported our reasoning that a backwards-facing approach would represent ringfencing based on actual supply figures and was similar to other environmental and social schemes that we administer. Stakeholders in favour of immediate implementation noted that our timelines were achievable and would allow suppliers sufficient notice to make necessary changes and, if needed, secure RO Credit Cover Mechanisms. Some stakeholders reflected that swift implementation would immediately change the behaviour of suppliers relying on customers' money and thereby significantly reduce the moral hazard that we are seeking to address. Respondents in support of the proposals also noted that the RO represents a pass-through cost that should not be used by suppliers as cheap working capital for commercial or operational benefits. Some respondents reiterated they had been driving for more robust measures on RO for some time, and were pleased we had advanced to statutory consultation. At a more general level, respondents supported the shift to a more prudential-style framework.

2.9 A minority of respondents supported the proposals but requested a delay or phasing of implementation. Each advocated for a deferral for different reasons; one stated that the cash required would need a two-year transition to raise and asserted that a phase-in could give time for the market to return to more favourable conditions. One said a 12-month deferral would be sufficient and contrasted our timelines to the five months suppliers had from the Decision to the implementation date of the Green Gas Levy (GGL), which was to cover a much smaller sum. One respondent argued that immediate implementation could be destabilising and trigger supplier failures and worsen the predicted negative impact on liquidity of the ROC market. Finally, one respondent argued that a phase-in was necessary as the current configuration of the price cap had not allowed suppliers to accumulate the cash reserves required to ringfence.

2.10 A minority of respondents objected to the proposals altogether. One gave no rationale or evidence as to why. Another respondent argued that that there was no appetite for lenders to invest in energy retailers, despite recently strengthened rules around resilience; they argued that it would be years of sustained profitability and steady return on investment, not additional rules, that would encourage investment. The final response argued that the proposals were unfair as large legacy suppliers could rely on cheap sources of capital whereas challenger companies would have to set aside cash, at a higher cost. This would lead, they argued, to a distorted market favouring incumbents over challengers.

2.11 On this same theme, one respondent supported the proposals but stated they would place "significant stress" on some suppliers with the potential for further failures. They requested that we take a risk-based approach and consider greater flexibility for smaller suppliers, because larger suppliers – with a greater proportion of the supply market – would have a greater negative impact on consumer bills if they failed. They suggested this could look like a reduced ringfencing requirement on smaller suppliers, who, they asserted, drive innovation and competition in the sector. This point was also raised by another supplier who argued the contrary; they made the case that any approach other than market-wide application would defeat the object of introducing the requirement and undermine competition in the market.

Non-domestic supply

2.12 The majority of respondents supported our position to exclude non-domestic electricity supply volumes.

2.13 Two respondents did not agree and argued that we should bring non-domestic supply into scope of the proposal. One argued that both domestic and non-domestic consumers continue to be exposed to costs associated with the risk of non-domestic supplier failure, and the low failure rate was not the correct "lens" through which to assess the problem. Instead, they suggested that we look to incidence of late payment as a sign of potential future default; and while they recognised that the historical failure rate of non-domestic suppliers was low, that we should act now to prevent future mutualisation costs from any future non-domestic supplier failures. Finally, they made the principled argument that non-domestic suppliers are accustomed to industry requirements to either pay more frequently or post collateral (e.g., against the Contracts for Difference obligation). The other dissenting respondent also put forward the principle of "doing the right thing" noting that while historically non-domestic supplier failure costs have been small, this was not a justification for excluding them from future requirements.

RO schedule and ROC issuance delay

2.14 Two respondents asked that we publish the indicative RO ringfencing timetable as soon as possible to allow them to prepare for the upcoming changes. One supplier noted that the number of ROCs registered will lag the relevant electricity supplied. Another supplier asserted that the lag could lead to double-counting, where suppliers hold ROCs on the Register during the period but also have RO Credit Cover Mechanisms in place. One respondent was concerned that a lag between energy generation and ROC issuance could result in penalties for non-compliance if the supplier has chosen to meet the new requirement using ROCs but does not hold them in their account when compliance is monitored. Finally, one supplier asked that we re-consider the problem of how to prevent suppliers from selling the ROCs – and therefore not being compliant – after the compliance window has passed.

Meeting the obligation

2.15 The majority of respondents said they would use a mixture of ROCs and credit cover to meet the new obligations. The primary reason given for the use of both was the flexibility this would afford suppliers. One respondent referenced the Cornwall Insight report[11] which noted that there would be "quarters in the year where there are either a surplus or shortage of ROCs", so the flexibility of using Protection Mechanisms would be very welcome. A small number would use ROCs only, referencing potential protection costs for businesses or uncertainty on their preferred approach. However, two respondents again noted the lag between the renewable energy being supplied and issuance of the ROC which one went on to note would mean that "almost all" suppliers will need to obtain credit cover through a Protection Mechanism at some point.

[11] Impact of increased settlement frequency on the Renewables Obligation - a review for BEIS (publishing.service.gov.uk)

2.16 One respondent repeated the request made in their policy consultation response for an 'any other arrangement' clause in the RO SLCs, so that Ofgem has the discretion to consider any "as-yet-unknown" Protection Mechanisms which could provide "efficient alternatives".

Price cap adjustment allowance

2.17 Of those who engaged with this question, three stakeholders supported the principle of the adjustment allowance. Two respondents said the allowance did not seem inappropriate, but the limited data provided meant they couldn't assess the cost impact fully. One respondent was cautious to draw a conclusion because they needed more time to consider ringfencing alongside the recent EBIT consultation. Most other respondents did not think the cap allowance as proposed accounted for costs that an efficient supplier might incur in ringfencing their RO receipts.

2.18 Some respondents objected on the basis that the true cost of obtaining a financial guarantee should be included in the calculation of operating costs under the revised price cap calculation. One noted that smaller suppliers will be subject to higher operating costs than investment grade suppliers who are able to benefit from parent company guarantees. A further two expanded on this theme and challenged that the allowance was inadequate because the WACC assumption on which it was based was too low.

2.19 One supplier welcomed that we recognised cost to suppliers but referenced their response to the EBIT consultation where they noted one price will not suit all business models; they urged us to address "flaws" in the design of the price cap. Similarly, another challenged the concept of a notional efficient supplier and instead said we should rely on actual costs. A further respondent argued that the price cap had led to systematic under-recovery of costs over many years, and this meant suppliers had not built up the reserves to pay for ringfencing.

2.20 Two suppliers objected to any adjustment allowance whatsoever because they consider the price cap already includes sufficient allowance to cover the cost of ringfencing. One noted that the RO is already priced into their tariffs.

2.21 One supplier asked that the adjustment allowance be increased because they said the policy structure would result in suppliers protecting five additional months of

RO each year[12]. The supplier argued that the adjustment allowance should therefore be higher, because this five-month overlap[13] between the end of the scheme year and the settlement deadline was not represented in the allowance calculation.

Supplementary consultation on draft supporting documents

2.22 We received nine responses to the supplementary consultation on supporting documentation. Respondents welcomed the opportunity to comment, using their responses to raise clarificatory questions on technical aspects.

Draft RO schedule

2.23 One respondent supported our proposed timeline, pointing out that customers remain exposed to systemic risks unless action is taken to ensure their financial resilience and sufficient capitalisation. They asked that we do not delay the proposals to ringfence Q1 and Q2 from the scheduled implementation date in Quarter 3 2023.

2.24 Two respondents did not support the timeline, and instead requested that we consider a phased approach to implementation. They argued that the requirements represented a significant uplift in capital requirements that would otherwise go towards decarbonisation and operational contingencies. One of these suppliers specified that an additional 12 months would mean they would be able to finance the proposals without recourse to group funds.

2.25 One respondent queried that 10 working days after the final day of the quarter was not enough time to obtain accurate domestic supply volume data and asked that we use Settlement Final data instead, which is only available on the 16th working day of the month.

RO Guidance

2.26 Responses here generally focused on requesting clarity or added detail. For example, one respondent asked that we clarify how we would handle a split rating (i.e., if it has been granted a BBB from S&P and Baa3 from Moody's). One

[12] This is because the scheme year ends (31 March) five months before the RO settlement deadline (31 August), so from 1 April-31 August suppliers are still holding the entirety of the previous year's obligation, as well as five months' worth of the new RO Quarterly Cumulative Obligation, before settlement.
[13] The disparity exists to allow both generators and suppliers sufficient time after the close of the year to receive and trade ROCs before they must redeem them. It has also been captured in the IA.

respondent welcomed the stance we have taken on permitting suppliers to amend the RO Credit Cover Mechanisms as this limits the possibility of having overlapping credit cover agreements in place and ensures they will only ringfence the exact funds for their RO.

2.27 One respondent detailed several questions on the treatment of ROCs: for instance, they asked how the annual limits on banked and bioliquid ROCs would be applied to quarterly periods. They also sought more detail on the cut-off dates for ROCs to be held in account to be included in the calculation of the Quarterly Amount, and how we proposed to handle legacy ROC offtake contracts which are handled monthly.

2.28 One respondent asked for clarity on how suppliers should identify domestic supply volumes, and suggested we look to the Warm Home Discount profile classes.

2.29 Two respondents challenged our proposal that the credit cover amount should be protected for at least an additional 28 days after the end of the quarter. They argued that as the supplier is required to protect the cumulative amount in each quarter until it has discharged its RO in full, the additional 28 days were superfluous.

Standby Letter of Credit (SBLC)

2.30 Of those that engaged with the template, one respondent sought detail on the scope of assignment, and the acceptability of the template to potential Issuers of an SBLC. Two respondents asked that the template show more flexibility on expiry dates, which are currently set at 18 months, to allow them to use facilities with different expiry dates.

2.31 One respondent argued that procuring an SBLC would confer a competitive advantage to suppliers with a stronger credit position than independent suppliers who do not have a credit rating.

First Demand Guarantee

2.32 Of the respondents who engaged on the First Demand Guarantee (FDG), two argued that it should be permitted to be guaranteed by a person established in the UK and EU. They stated our requirement for a guarantor based in the UK was unnecessary as the template wording meant that all rights would be enforceable under UK law; furthermore, it would disadvantage suppliers with parent companies that are based outside the UK.

2.33 One respondent objected to the inclusion of FDGs as they are cheaper than other forms of credit cover and so give legacy suppliers with parent companies an advantage over non-investment-grade-rated suppliers. They suggested that removing parent company guarantees as a PM altogether would level the playing field.

2.34 Respondents also provided specific feedback on legal definitions, such as additional detail on the definition of Expiry Date and Non-Payment Events.

Escrow agreement

2.35 We received no feedback on the escrow template.

Declaration of Trust

2.36 One respondent engaged on the declaration of trust template. They asked that we clarify whether withdrawals cease to be Trust Property and requested that we add an express clause to this effect. They sought clarification on naming the Beneficiary and asked for longer than 10 days to discharge a vexatious petition in case of a Credit Event.

Our decision

2.37 Having considered stakeholder views and evidence and conducted further analysis, we continue to believe that proceeding with market-wide ringfencing of RO attributable to domestic supply for scheme year 2023/24 represents an important component of our wider strategy for improving suppliers' financial resilience.

2.38 Suppliers will be required to ringfence their RO attributable to domestic supply for Q1 (Apr-Jun) and Q2 (Jul-Sep) of the scheme year 2023/24 jointly in Q3; this is to allow time for suppliers to secure credit cover and establish internal processes. The first reporting cycle will be from the end of Q2. Per the RO ringfencing schedule, suppliers will submit their domestic supply volumes for Q1 and Q2 through the Central FiT Register (CFR) by 13 October 2023, and provide evidence for RO Credit Cover and/or present ROCs by 10 November 2023. Subsequent quarters will adhere to the following schedule, found in the RO ringfencing guidance:

Event	Number of working days
Supplier submits Relevant Domestic Electricity Supply (RDES) on CFR	1 to 10 after end of quarter
Ofgem notifies supplier of QCO	20 after end of quarter
Deadline for providing evidence of ringfencing arrangements	30 after end of quarter
Ofgem notifies supplier of compliance status	40 after end of quarter

Ringfencing 100% of RO for scheme year 2023/24

2.39 We do not consider that there is a case for phasing in the RO domestic supply ringfencing requirement. This is for several reasons. Firstly, the proposals have been well trailed: they were tested originally in a policy consultation in 2021, followed by a commitment in the December 2021 Action Plan[14] and an open letter in April 2022[15]. This was followed by the policy consultation in July 2022, together sending strong signals to the market that we intended to act in this area. We do not consider that waiting for market conditions to stabilise is a sufficiently good reason to delay implementation as it remains possible for the market to remain volatile for a number of years and this policy seeks to ensure suppliers are appropriately managing risks in the market. We also note that the backwards-facing, quarterly milestone nature of the proposal does mean that there is a natural ramp-up in credit cover and financial requirements as the year progresses. We conducted analysis of stress test financials which found no evidence that phasing in ringfencing would lead to better consumer outcomes.

Stress testing returns analysis

2.40 We reviewed the results of the Q1'23 financial stress test of domestic suppliers in which suppliers were asked to consider the implications of ringfencing RO receipts from April 2023[16]. These tests examined supplier finances in four wholesale price scenarios (central, low, high, and very high) given the uncertainty on external market developments. Based on some suppliers' responses, we studied different scenarios of phasing in the implementation of the ringfencing requirements (e.g., only 50% in year 1, and a 12-month delay). We examined the number of periods each supplier entered negative liquidity (i.e., where monthly cash demand exceeds available cash and undrawn facilities) and the extent of illiquidity on financial stability.

2.41 Our analysis found that there is no material difference in outcome if the RO ringfencing requirement were phased-in compared to our proposal. A phased approach does not therefore appear to have a material consumer benefit when considering reducing the risk of failure. This is true of all suppliers who responded requesting a phase-in or deferred introduction. We do not believe that

[14] Action plan on retail financial resilience | Ofgem
[15] Open Letter to domestic energy suppliers - Financial Resilience | Ofgem
[16] This data from suppliers is highly sensitive. Respecting that commercial confidentially means that we cannot publish that data or analysis derived from it. The analysis is not meaningful when aggregated.

accommodating these sums within financial arrangements is impractical, particularly given the pass-through nature of RO receipts. We remain concerned that suppliers are relying on money raised from customers through a pass-through cost to fund working capital and our decision today aims to prevent this practice.

Non-domestic suppliers

2.42 We do not consider there are persuasive arguments to extend ringfencing to non-domestic suppliers. Whilst it is true that non-domestic suppliers are continuing to face high costs which may exacerbate the risk of failure, non-domestic suppliers have a much lower failure rate and associated mutualisation risks. The appetite from respondents to extend the proposals to non-domestic was very low. Due to these factors, we have decided to exclude non-domestic supply from these requirements. However, there is an ongoing review of the non-domestic market, and we continue to collect data from non-domestic suppliers through the regular monthly RFIs. If that uncovers sufficient evidence, we will consider re-consulting on this issue in the future.

ROC schedule and ROC issuance delay

2.43 On 14 March we published the draft RO schedule[17]. This set out that suppliers have 30 working days after the end of each quarter to source either RO Credit Cover Mechanism(s) or present ROCs, or a combination of both. This is to align with the timings set out in the annual FiT levelisation schedule.

Timing of proposal

2.44 We want to ensure that despite the ringfencing requirement going live from 1 July 2023, that the accrued RO in Q1 (April-June) is still protected. To deliver this, in 2023 only, suppliers will be required to ringfence their accrued RO for Q1 at the same time as Q2 (July-Sept) by the deadline date on 10 November 2023. We consider this approach to have several benefits over the alternative proposals of requiring ringfencing after the end of Q1, or leaving Q1 unprotected in the first year. Firstly, it better meets the policy aims to reduce the cost of mutualisation than not ringfencing Q1 at all. Secondly, unlike the option to require suppliers to protect Q1 2023 after its end, suppliers will have 7.5 months from Decision to secure RO Credit Cover Mechanism(s) rather than just 4.5 months. Based on conversations both in bilateral meetings with suppliers and with commercial

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[17] Renewables Obligation: Guidance for suppliers | Ofgem

banks, we consider this to be sufficient time for suppliers to be able to source RO Credit Cover Mechanism(s), if required, to meet their ringfencing obligation. Finally, given our proposed approach to cost recovery with the adjustment allowance, requiring cover for Q1 and Q2 by the deadline date on 10 November 2023 allows suppliers to recoup their costs ex-ante (i.e., within the same cap period), and so addresses concerns around cashflow impact of this policy. In summary, our approach ensures that both quarters are protected in line with policy aims and suppliers will have a reasonable time frame to prepare their processes.

2.45 Given the implementation timetable for this requirement, we will be seeking evidence from suppliers as to how they intend to meet this commitment. This is to ensure we can monitor and address issues in a timely way. We propose that from 1 July – 11 November 2023 we will implement a period of enhanced monitoring to get an early alert of non-compliance and possible supplier failure. During this period, suppliers would be required to submit their supply volumes on the CFR and we will calculate their QCO. We will then share the QCO back to suppliers and ask how they intend to meet it (whether by ROCs, PMs, or a combination, and if relying on PMs, which one they will use), with a reminder that it will be due jointly with their Q2 obligation.

2.46 As part of a wider point around ROC issuance, one supplier noted a concern around 'double counting’, where the supplier accidentally over-insures their QCO because of a delay between a ROC purchase and it appearing in their account. We do not consider this to be a concern as ROC purchases appear in the supplier’s account instantly, reducing the possibility of a mismatch. As set out in the Guidance, we will be very clear when notifying suppliers of their QCO, giving ample time for a supplier to, for example, sell excess ROCs.

2.47 As suppliers will be aware, in Q1 they can find themselves with ‘unassigned’ ROCs left over from the previous year, so come July they appear to have more than they have supplied. By the time we reach Q2 these unassigned ROCs have usually cleared. This may have been what the respondent had in mind when referencing double counting. In any case we consider it better that a supplier overprotects than under protects their QCO.

2.48 We acknowledge that due to the 2.5 month lag in ROC issuance only a month’s worth of ROCs for a given quarter will have been issued to the operator by the deadline date. Whilst it is true that if the ROCs are not available, suppliers must use an RO Credit Cover Mechanism(s) to cover the remaining amount, we do not expect this to be a significant issue. Firstly, suppliers can bank up to 25% of their

ROCs for the following scheme year, which they will continue to be able to do under the new requirements. Used judiciously, banked ROCs can address concerns about ROC availability in Q1. Secondly, as noted above, the RO ringfencing schedule permits suppliers 30 working days after the deadline date to demonstrate proof of ringfencing, meaning a second month's worth of ROCs will have been issued by the time they must demonstrate compliance. This lessens the impact of the delay of ROC issuance.

2.49 We also acknowledge that the timing of the implementation of these proposals means that suppliers will be required to protect their Q1 and Q2 2023/24 obligation just after the annual scheme's late payment deadline (31 October) in respect of their 2022/23 obligation. Suppliers should note that we expect them to ensure that they meet their 2022/23 obligation, and we would expect to take enforcement action in the usual way where they fail to do so.

Suppliers selling ROCs after demonstrating compliance

2.50 In the policy consultation, we attempted to address the potential issue of suppliers selling ROCs after demonstrating compliance by proposing to create a trust over sale of ROC proceeds; this proposed solution was rejected by almost all respondents as unworkable and costly. Furthermore, respondents (including generators) noted imposing this type of restriction would undermine the dynamism of the ROC market. Restricting sales of ROCs would reduce the liquidity of the ROC market and thereby potentially have adverse consequences for broader decarbonisation objectives. However, we recognise the concern and have drafted in an additional condition SLC 30.3A to require that the licensee shall not complete a transfer or sale of some or all of the ROCs held on the Register that form part of the QCO, until they confirm to us, with evidence, that they have protected the increased RO Credit Cover Amount that will result from the transfer of the ROCs.

2.51 Furthermore, suppliers should note the requirement under SLC 30.1 that they must "continue" to hold their QCO and Credit Cover Amount until settlement, and the requirement under 30.3 that they notify us of the termination, expiry, or change of the credit RO Credit Cover Mechanism(s). We also expect that under SLC 4B (the Financial Responsibility Principle) suppliers will notify us if they sell ROCs that mean they are no longer fully ringfencing the QCO. We will monitor performance with these requirements.

Meeting the obligation

2.52 In our decision we have retained the previously proposed menu of Protection Mechanisms apart from the removal of the Escrow option (see below). We will not, as suggested by one respondent, include wording in SLC 30 to accommodate an 'any other arrangement' clause. We do not consider there to be a case to extend the current SLC drafting to include an allowance for bespoke Protection Mechanisms. If circumstances change in the future, we will keep this under review[18].

2.53 In the policy consultation on SLCs for ringfencing credit balances, we included a clause which offered an option (d), i.e., "Any other arrangement that meets the requirements of paragraph 27.22 and which has been approved by the Authority in writing for the purposes of this condition." We removed this for the statutory consultation SLCs as we were concerned it would create uncertainty and additional cost to arbitrate and approve bespoke credit cover. We did not receive any suggestions from the respondent on alternative Protection Mechanisms. The earlier consultation response also did not contain evidence or explanation on possible alternatives. We consider that allowing leeway to negotiate complex and lengthy bespoke options, which have not been raised in the ample time provided since policy consultation, does not lead to regulatory certainty that suppliers have told us they need. We also consider the case of the GGL, where suppliers are required to use only the Letter of Credit (LoC) template provided by Ofgem to ensure the process was as simple as possible. We have received significant support for the flexibility provided in the menu of options and not received feedback asking for additional options.

2.54 We have decided to remove the Escrow option from the menu of Protection Mechanisms. We consider that suppliers who may have opted for Escrow can protect the RO as effectively through a Trust. We therefore do not consider that therefore is any benefit to including the Escrow option and that it is simpler to

[18] We do not consider it efficient to accommodate bespoke arrangements and ad-hoc amendments from suppliers 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.

reduce the menu to three options. We did not receive any feedback on the Escrow option and no supplier has indicated that it intends to use this option.

The price cap allowance

2.55 We consider that is proportionate and fair to permit suppliers to recover costs associated with ringfencing RO receipts through a temporary uplift to the cap allowance until the EBIT consultation decision is concluded and implemented.

2.56 The majority of objections to this proposal were that the cost of obtaining a financial guarantee should be included in the price cap, which is out of scope of this consultation. We have instead provided what we consider to be a fair reflection of the cost of obtaining credit cover to suppliers, i.e., the CMA's assumption of a 10% WACC. The price cap legislation prevents us from setting supplier-specific price caps and does not permit different caps for different business models. We note that because of the diverse and competitive nature of the market, relying on a single WACC will mean that some suppliers may slightly under-recover while others may slightly over-recover costs. We believe that, like other price cap allowances, this enables those suppliers in stronger financial position to be more competitive. An ex-post approach would exacerbate existing concerns with suppliers' cashflow and we consider it fairer to allow the cost to be recovered in the same period.

2.57 Because the adjustment allowance consulted for in the November statutory consultation covered only price cap period 10a and was due to permit cost recovery in that same quarter, it is now out of date. For this reason, we have decided that suppliers will be able to recover costs for ringfencing RO receipts from Q1 and Q2 through an additional allowance of about £8 per typical single-rate electricity customer (on an annualised basis) in cap period 10b, i.e., 1 July 2023 – 30 September 2023, ahead of the need to demonstrate compliance by 10 November 2023. The details of the calculation are set out in the adjustment allowance to Annex 8 published alongside this consultation. Beyond this, suppliers will be able to recover costs for ringfencing the RO through a permanent change in the EBIT portion of the price cap methodology.

2.58 Since suppliers will only be required to ringfence their RO receipts attributable to domestic supply from Q1 2023/24, they will only need to ringfence amounts more than 12 months in May 2024 by which time we intend to have made a permanent adjustment to the EBIT allowance methodology to account for the ringfenced amounts within capital employed. Hence, during the time the interim allowance is effective, we do not consider that suppliers will have incurred the costs of protecting peak RO receipts to cover the additional five months of RO between the end of scheme year and settlement date. We will revisit this situation in the unintended situation that a permanent adjustment to the EBIT allowance is not possible in sufficient time.

Supplementary consultation on draft supporting documents

2.59 Given the very detailed and specific nature of the feedback on these documents, these are set out in Appendix 2 below.

3. Protection mechanisms

Section summary

In this chapter we detail what we consulted on in November in relation to protection mechanisms for RO receipts, stakeholder feedback and resulting decisions. We have decided to proceed with protection mechanisms, other than the Escrow Account option which we have removed, as they offer insolvency remote protection of funds, with the highest standard of credibility being in the consumer interest. We also have decided to proceed with minimum credit ratings as described in the statutory consultation. The protection mechanisms will not apply to credit balances as our decision on these is subject to a further statutory consultation.

What we consulted on

3.1 We proposed that suppliers should protect both their domestic RO liability and CCBs by using one or more Protection Mechanisms (PMs) from an approved "menu" of options. The five proposed mechanisms were a Trust Account, Escrow Account, Third Party Guarantee (TPG), a Parent Company Guarantee (PCG), and a Standby Letter of Credit (SBLC). We proposed that First Demand Guarantees (FDGs) (covering both PCGs and TPGs) should be lodged with an institution of BBB or equivalent. We also proposed that SBLCs must be lodged with an Acceptable Bank (i.e., have a rating of F1, P-1/A3, A-1 or better). This would be to provide a maximum assurance of continued protection.

Summary of responses

3.2 Seven respondents argued that the requirements would disadvantage smaller suppliers. Four of these said the proposals would be costlier for suppliers not backed by a parent company. The "very low cost" of PCGs when compared to escrow accounts led them to urge Ofgem to ensure the PMs would only be permissible when "equally available to all suppliers, and on an equal basis" with the implication that to do otherwise puts these suppliers at a competitive disadvantage. Another respondent asked that we consider an approach like that in the banking sector where there is a differentiation in ringfencing procedures for small and large institutions. By contrast one respondent asked that we impose the toughest measures on the weakest suppliers because risky business models should be subject to the strictest controls. One supplier argued that energy retail companies that are part of larger groups do not contribute to the investment grade rating of the parent company, but nevertheless they would unfairly benefit from cheap protection from a PCG. They presented evidence of another supplier's financial records showing the negative EBIT of the UK domestic supply division last financial year. They argued that this evidence showed the parent company's credit rating is due to its infrastructure asset base, not the child retailer and argued PCGs would be "distortive".

3.3 Two respondents challenged us on why we would require a PCG to be lodged with "a person established within the United Kingdom". They argued that it was standard practice for counterparties to accept a PCG from outside the UK if it is a guarantee governed by UK law.

3.4 Two respondents supported the concept of minimum standards but suggested amendments to our definitions. They asked that we lower the requirement for an FDG to accommodate BBB- / Baa3 ratings, which they argued are still investment grade. They also asked that we align with existing practice elsewhere in the energy sector and use minimum A- (S&P or Fitch) or A3 (Moody's) for SBLCs and letters of credit.

3.5 One respondent sought clarity and asked us to add in a long-term debt rating threshold of A- (Standard & Poor) or A3 (Moody's).

3.6 Three suppliers requested clarity on the appropriateness of UCP 600 and ISP 98 as standards for SBLCs.

Our Decision

3.7 We have decided to proceed with PMs (other than the Escrow Account) because they offer insolvency remote protection of funds. We also have decided to proceed with minimum credit ratings as described in the statutory consultation and SLC 30, and are widespread in other related sectors such as water supply. Credit ratings provide an indication of the chance of default within a certain horizon. The Protection Mechanism templates, which must be lodged with Acceptable Banks or appropriate guarantors, provide legally robust payment obligation in case of failure. Ensuring the cash is insolvency remote will reduce the cost of mutualisation. There is a principled argument to require the highest achievable standards support credibility in the consumer interest.

3.8 While it is true that some suppliers can access cheaper credit (see below), all suppliers will have access to an allowance within the cap, as noted above, to recover RO credit cover costs. Minimum credit ratings are used elsewhere successfully, such as the GGL and regulation of water companies.

3.9 We have decided to remove the option of using an Escrow Account as we do not consider it to be materially different from the Trust Account Protection Mechanism (as explained above under the heading "Meeting the Obligation").

Credit rating thresholds

3.10 We have decided to proceed with the credit rating requirements. We have made small changes based on feedback and norms in corporate finance. We will accept BBB (including BBB-) for FDGs, and long-term debt ratings of A- or better (Fitch), A3 or better (Moody's), or A- or better (Standard and Poor's) for SBLCs. In the case of a split rating, i.e., where a supplier has different ratings from two agencies, we will base our assessment on the lower rating. A company with a split rating of which one is not investment grade rated will not be acceptable.

3.11 For FDGs, we propose to align with the requirements for the GGL, recognising that this approach is established and familiar to suppliers and Ofgem. For RO ringfencing requirements, we have expanded the definition of BBB to include BBB- (S&P and Fitch) and Baa3 (Moody's). BBB-/Baa3 is an internationally-recognised benchmark of investment grade rating, and we consider that BBB-/Baa3 is represents an attainable and reasonable standard. The reason for divergence in minimum requirements between FDGs and SBLCs accounts for the credit status of parent companies with subsidiaries in the energy retail market. We are aware that it is usual for corporates, like parent companies, to have lower credit ratings than banks. We also note that it would not be possible for a supplier to source a compliant SBLC as we require it to be lodged with an Acceptable Bank, and no eligible banks have a credit rating lower than A.

3.12 We are committed where practicable to require the highest possible standards to minimise the cost and incidence of mutualisation. We accept the argument that BBB-/Baa3 is considered an investment-grade rating; BBB ratings indicate that expectations of default risk are currently low (0.14% in Y1 rising to 0.71% by Y5). We note that BBB to BBB- (and equivalents) represents a slight downgrade from our position in the statutory consultation, but it is a small one which would not undermine the integrity of the policy intent. We considered the recent decision by Ofwat to raise the cash lock-up trigger to BBB due to concerns about declining credit quality among their licencees[19], but we did not consider this a valid comparator to energy suppliers because water companies own very large

[19] Consultation on proposed modifications to strengthen the ring-fencing licence conditions of the largest undertakers - Ofwat

assets in regional monopolies. By contrast, the energy retail sector is competitive and diverse, with some suppliers operating asset-light business models. As noted above with the GGL, we prefer alignment where practicable which reduces complexity for licencee's financial considerations.

3.13 In setting the minimum requirement for FDGs we aim to account for the clear degree of interest a parent has in a subsidiary compared to a separate financial institution, and believe that this level is likely to strike an appropriate balance between achieving a high standard while averting excessive cost which could be passed through to customers.

Parent company guarantees

3.14 We are not minded to exclude PCGs from the list of PMs because they are widely accepted in corporate finance; they are insolvency-remote in case of the failure of the energy supplier; they will be subject to minimum standards; and the templates we have prepared have set out robust conditions to prioritise the consumer in case of supplier failure. As shown in the IA, implementing market-wide ringfencing will reduce the cost of supplier failure for current and existing suppliers, thereby reducing risk and cost for future customers. Forcing those who can access cheaper credit to pay more for something equivalent, that they can obtain more cheaply, will increase cost to consumers. To force those who can access cheap credit cover to bear additional regulatory cost will not increase fairness in the market.

3.15 We have recognised the cost of ringfencing the RO and have therefore developed a temporary cost adjustment allowance to support the transition. This will be supplanted by a permanent uplift to help suppliers recover the cost of the RO from the recalibration of the EBIT allowance.

3.16 We acknowledge responses arguing that there are competition implications if we proceed with allowing PCGs as a form of credit cover, because they are available to only the largest legacy incumbents and therefore "unfair". However, we note that due to the diversity of the market there are suppliers of numerous sizes and business structures, that necessarily face different challenges. As a general point of principle, we do not think that competitive advantage arising from financial strength is a problem in itself.

3.17 We have carefully considered the impacts of the ringfencing approach on competition, and we are cognisant of the need to balance this consideration with our duty to ensure that all suppliers are financing themselves responsibly. For this reason we have decided to permit suppliers to use a 'menu' of options for credit cover – which is more flexible than only allowing a single form of cover, as with the GGL – or purchase ROCs. We must consider the balance of incentives overall and note that in other areas, such as meeting ECO requirements, other suppliers benefit from exclusion from regulatory duties.

3.18 We do not consider the contribution of UK energy retail to parent company rating is sufficient to warrant discarding PCG as a valid PM.

Cost of non-FDG Protection Mechanisms

3.19 We noted the concern from some respondents who are not investment-rated on the cost of obtaining credit cover if they did not have access to FDGs, but we did not receive evidence substantiating these concerns. We therefore do not consider this to be a reason to avoid proceeding with the minimum requirements. Currently, the cost of failure sits with the customer when a supplier fails. This is passed on through the SOLR levy. The IA has found that there is a positive Net Present Value of £227m over six years, equivalent to £44m per year, to ringfencing 100% of the RO. The range of options in the menu of PMs ensures that a wide variety of businesses will be able to meet the requirements. Suppliers concerned about access to credit cover can also meet their obligation by purchasing ROCs.

3.20 As noted in the RO chapter, we recognise that ROCs are less available in the early part of the year due to seasonality and so it is highly likely that suppliers will have to rely on credit cover for Q1 and possibly Q2 for at least part of their QCO. Furthermore, up to 80% of ROCs are sold as bundled with PPAs. Both of these factors affect availability, especially in the earlier half of the scheme year when supply volumes are naturally lower. However, suppliers can carry over (or "bank") 25%[20] of ROCs to the following year. Seasonality does also mean that demand in Q1 and Q2 is significantly lower than Q3 and Q4, so we do not anticipate that this will result in significant cost changes for suppliers.

Small supplier carve-out

3.21 We do not agree that a lighter touch approach for smaller suppliers is appropriate here. The suggested carve-out for small suppliers is in place in a sector – banking – which is already subject to tougher capital adequacy controls than those in energy retail. The RO is a pass-through cost levied on electricity customers, unlike flexibility given to new entrants in finance, so the comparison with banking

[20] See Section 4.4 of the RO Supplier Guidance.

is not accepted. Suppliers must also consider that bespoke arrangements result in further administrative costs. We also consider that a single approach for all suppliers meets the policy objective to reduce costs to customers.

Non-UK guarantors

3.22 We wish to encourage diversity within the energy retail sector of suppliers which includes independent suppliers and those part of a larger group. We noted responses which emphasised their parent companies or counterparties located in economically stable countries with strong credit ratings and transparent regulatory regimes. Furthermore, the templates ensure that any PM will be enforceable under UK law. We have therefore decided that suppliers may lodge a Protection Mechanism with a person established within the United Kingdom or in an EU member state, or European Economic Area member state, that is bound by the 2005 Hague Convention on Choice of Court Agreements[21]. Any PM not lodged with an EU / UK institution referred to in the 2005 Hague Convention on Choice of Court Agreements will not be accepted. A PM must not be lodged in a country which is under current UK Government sanction.

Short- and long-term debt ratings

3.23 We accept that where stipulated a short-term requirement should also (or only) have a long-term debt rating requirement and so have amended the SLCs to reflect this. In addition to consultation responses, we noted that in corporate finance contexts, ratings were usually expressed in long-term rather than short-term ratings, and that therefore a long-term rating is usually sufficient. We should seek to apply the norms used in corporate finance contexts where possible as these reflect the conditions in which our licensees are operating.

Removing Escrow Account as a Protection Mechanism

3.24 We have decided to remove the option of escrow as a PM. We consider that suppliers who may have opted for Escrow can protect the RO as effectively through a Trust. We therefore do not consider that therefore is any benefit to including the Escrow option and that it is simpler to reduce the menu to three options. We did not receive any feedback on the Escrow option and no supplier has indicated that it intends to use this option.

[21] HCCH | Choice of Court Section

Definition on Non-Payment Event

3.25 To note that we have clarified the definition of Non-Payment Event in the templates to ensure that it is in line with the relevant RO legislation.

4. Appendices

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Appendix 1 – Final Notices and consultation responses

This appendix lists and provides the link to the documents that we have published alongside this Decision, consisting of:

- Non-confidential stakeholder responses to our November 2022 Statutory Consultation
- Updated Impact Assessment and model
- Electricity and gas decision notices for SLC 4B
- Electricity decision notice for SLC 30
- Updated FRP guidance
- Updated RO ringfencing guidance
- RO Ringfencing Schedule 2023/24

Appendix 2 – RO guidance consultation summary

Issue raised	Our view	Outcome
RO RINGFENCING SCHEDULE		
Ofgem should use Settlement Final data. This data is available on the 16th working day of the month and Ofgem should factor a further 5 working days for suppliers to submit their calculation via the CFR.	• We prefer to retain the same timelines as the FiT levelisation schedule as this streamlines the process for both us and suppliers. • Suppliers will need to submit the same data, based on the same flows, just without non-domestic volumes. • There is no difference with what they submit on the CFR; when suppliers are completing levelisation a partial amount of their supply will be Settlement Final data (i.e., estimated).	No change to position
GUIDANCE		
Ofgem should explain to stakeholders how it is using its legislative powers to require mandatory guidance through SLC 30.4.	The guidance is not mandatory but clarificatory. This has been clarified for suppliers in the guidance wording and in SLC 30.4.	Included
Amendments to the Maximum Amount are not allowed on the same basis across different credit cover mechanisms. These requirements should be uniform so that suppliers all face the same obligations.	The Maximum Amount is amendable in an FDG and SBLC because these are the only two of the four Protection Mechanisms where that amount is relevant - Trusts and Escrow are accounts where the amount will fluctuate all the time depending on the obligation and to note we have now removed the Escrow Account option. In the Declaration of Trust, there is the ability for suppliers to withdraw amounts in excess of the then applicable RO Credit Cover Amount. We support suppliers amending the Maximum Amount in an SBLC at any time but may amend the Maximum Amount in a FDG no more than once per Quarter given that we expect the majority of FDGs to be intra-group and therefore that it will be cheaper for suppliers to secure a higher "ceiling" Maximum Amount that they perhaps would be able to with an SBLC.	Not included

Issue raised	Our view	Outcome
Ofgem should accept changes from the standard documents (templates) where Ofgem considers those as necessary or otherwise reasonable.	The more frequent an instrument is amended the more likely the amendment or the amendment process will accidentally prejudice Ofgem's rights under the amended instrument. We do not consider it efficient to accommodate bespoke templates and ad-hoc amendments from suppliers 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.	No change to position
The guidance should include a process for suppliers to draw down on ringfenced funds between quarterly compliance confirmations.	The SLCs allow for this i.e. if a supplier protects a certain amount at the beginning of the quarter but then buys ROCs mid-quarter the amount it then needs to protect via a PM decreases. This means that they can decrease the amount held in a Trust, SBLC or FDG. Cl. 2.3 of the Trust Terms cover withdrawals when the RO Credit Cover Amount/Protected Amount is lower than the amount standing to the credit of the relevant account.	No change to position
After receiving the QCO the supplier is then required to provide evidence on ringfencing arrangements by 30 working days after the end of each quarter. What evidence should be provided in addition to the Credit Cover Mechanism as defined in SLC 30?	In SLC 30, we ask that suppliers provide "evidence that the licensee's RO Credit Cover Mechanism(s) Protect the most recently calculated RO Credit Cover Amount". This only applies to trust, where we will require them to share a bank statement proving they have deposited the correct amount. This has been clarified in the SLCs.	Amended SLCs
What date would the supplier be expected to calculate the Credit Cover Amount?	Suppliers will not need to calculate the Credit Cover Amount; suppliers would be required to submit the RDES within 10 working days after the end of each quarter. This has been clarified in the SLCs.	Amended SLCs
Can Ofgem confirm that all ROCs in the suppliers account would be included in the calculation of the Credit Cover Amount regardless of whether they were purchased with respect to obligations for relevant domestic electricity supplied?	ROCs are not classified according to whether they were associated with domestic or non-domestic supply. Any ROCs can be used to meet a supplier's domestic ringfencing obligation.	No change to position
The RO Order requests suppliers to submit their total electricity supplied and makes no distinction between domestic and non-	In accordance with Energy Price Guarantee for domestic electricity consumers in Great Britain: Scheme document, we expect domestic supply volumes to be derived using the Consumption Component Class	Guidance clarified

Issue raised	Our view	Outcome
domestic. How should suppliers identify domestic volumes?	Id's 42 & 45 for half hourly volumes and Profile Classes 1 & 2 for Non half hourly volumes.	
The guidance should include a reconciliation process for previous quarters' calculations to ensure that suppliers are not exposed to unnecessary ringfencing requirements in scenarios where initial demand is overestimated.	• We have considered the administrative impact on suppliers and Ofgem of reviewing a cumulative value each quarter. It would be unnecessarily burdensome to create an additional reconciliation process which would require very frequent contact with suppliers • Because RO ringfencing does not interact with the RO scheme in the same way, there is an element of estimation. However, our feasibility study has shown that the margin of error is <1% • Unlike data submissions for quarterly FiT levelisation, those for RO ringfencing are not used to calculate a supplier's actual liability to the RO scheme.	No change to position
Alignment to the R&CHP Register this would be operationally simpler for suppliers than utilising the CFR to submit data	Submission to the CFR aligns with the FiT levelisation schedule, which significantly lowers the admin burden for suppliers	No change to position
Additional detail should be provided on the cut-off dates for ROCs to be held in account in order to be included in the calculation of credit cover amounts.	Suppliers must ringfence their RO throughout the year. Ofgem will confirm back to suppliers whether they have met their obligation 40 working days after the end of the quarter.	No change to position
Clarification should be provided on how annual limits on banked ROCs, bioliquid ROCs, and ROCs from legacy offtake contracts will be applied to quarterly period	Determining how annual limits apply to ROCs is outside the scope of the consultation. Monthly ROCs can be used for the upcoming deadline date.	No change to position
How can credit cover amounts be amended during the quarter where additional ROCs are purchased and received by suppliers?	The procedure to amend Quarterly Amounts is set out in SLC 30.3.iii. Suppliers must ringfence at all times, if they sell ROCs they must update their RO credit cover accordingly.	No change to position
We need to clarify the situation in which the supplier would need to hold on to cover for +28 days after the end of the quarter (i.e., replacing the RO Credit Cover Mechanism in case of discharge)	This has been removed.	Guidance clarified
Can SBLCs be extended by way of an amendment (not just the value amended), rather than having to issue a new SBLC as this is standard practice elsewhere?	This is acceptable in principle.	No change to position

Issue raised	Our view	Outcome
It is helpful to have the ability to swap in alternative forms of credit cover from time to time, and to have the ability to provide more than one form of credit cover at the same time, as long as they meet the requirements. Could Ofgem formalise the ability for suppliers to amend the amount of the credit cover in some circumstances, e.g., the maximum amount under SBLCs?	We expect the majority of FDGs to be intra-group arrangements where it will be cheaper for a supplier to secure a higher Maximum Amount that they do not have to regularly increase / decrease as frequently – we would not expect the Guarantor to charge the Licensee fees based on the Maximum Amount. The SBLC can be amended provided cover remains in place and this has been built in by enabling amendment of the Maximum Amount.	No change to position
SBLC		
Reduce the scope of Assignment or at least curtail it such that the assignment is restricted to another government body or similar.	Assignment was included as right in respect of CCB ringfencing which is now subject to further consultation. We have therefore removed the right to assign from the RO templates.	Templates amended
The current wording of Article 6 of the SBLC could be unacceptable to a range of banks as a matter of policy.	This issue no longer arises for the RO Credit Cover Mechanisms as the ability to assign drawing rights has been removed.	Templates amended
Article 7 modifies the rights of an Issuer not to act on assignment, which conflicts with Article 6 of ISP 98.	There are no non-documentary conditions in the template SBLC or FDG. The issuing bank or guarantor must pay against receipt of what appears on its face to be a complying demand that appears substantially in the form scheduled to the instrument and to contain one of three certifications. It is no concern of the issuing or confirming bank or the guarantor what any given certification means, or whether any given certification is accurate.	No change to position
The templates are designed as a standalone document and should not contain cross-references to Licence (or in fact any underlying agreements) except for referring to a number and date of those. All definitions, terms and conditions shall be in the template itself otherwise, in the case of an SBLC, could be disregarded by the issuing bank in case of a claim as a non-documentary condition.	We consider that it would be very hard to remove references to the relevant Licence without making the instrument so vague that it would be highly unfair to the Licensee.	No change to position

Issue raised	Our view	Outcome
Ofgem should allow the licensee to set the expiry date of an SBLC subject to the requirements set out in SLC 30. This will allow suppliers to make use of existing facilities which may have fixed expiry dates and make use of facilities which have a maximum 12-month expiry. Restricting allowed SBLCs to facilities with an 18-month term would increase complexity and potentially costs and is not necessary given the proposed provisions in SLC 30.	The 18-month period was set out so that a facility would cover the full RO scheme year. However, suppliers will have the ability to amend / supplement facilities mid-period. We are keen to combine reasonable flexibility with mechanics for ensuring appropriate cover is in place at all requisite times.	No change to position
Article 2, paragraph (b): We recommend that Ofgem increases the period to five business days to reduce the administrative burden on suppliers.	To achieve the policy intent, we need to be able to demand and receive any protected sums before midnight on 31 October as otherwise those sums cannot be deducted from the mutualisation amount in terms of the RO Order and RO(S) Order. We want to be able to ensure that suppliers have until as close as possible to the 31 October late payment deadline to pay their RO without us having drawing down on protected sums. Our templates therefore require payment within 3 rather than 5 business days.	No change to position
Article 5: We recommend that Ofgem includes the domain from which an email may be accepted in the template.	It is clear in the ringfencing guidance document that demands will come from an @ofgem.gov.uk domain.	No change to position
Article 5: some banks may be concerned that this allows for a Demand to be sent directly to the Issuer on paper with no requirement for the Beneficiary to submit a statement from their bank that they have authorised their signatures.	It is rare for a bank operating in London to require this. We do not think we should include it as the demand process may become too cumbersome to manage efficiently.	No change to position
Issuing banks may not like the inclusion of capitalised terms as they are keen to maintain the independence of the SBLC to the underlying regulations; capitalised terms should be kept to a minimum / only if strictly necessary.	The SBLC will be subject to ISP 98 or UCP 600 in any case, but the form of demand under the RO template for the SBLC is very simple and no issuing or confirming bank is entitled or obliged to concern itself with whether the statements made in a demand are true, or whether those statements make sense in the light of rest of the text of the SBLC.	No change to position

Issue raised	Our view	Outcome
Will Ofgem put in place adequate protections in place against fraud, given that email submissions will be accepted?	We will not share the RO bank account details publicly; however, the regular communications with suppliers will include these details to reassure creditors of legitimate requests. Pre-population is far from universal in SBLCs or FDGs issued for commercial transactions.	No change to templates
Flexibility to accept different banks' different execution blocks for issuance.	We have included square bracket execution blocks so that no particular wording is prescribed.	Templates amended
FDG		
Is it possible to issue by email rather than by uploading to the FiT Central Register? Banks will not have access to that, so they would not be able to issue directly to the beneficiary, whereas they would if they had an official Ofgem email address that they could issue to.	We will accept an upload to the shared mailbox [ROringfencing@ofgem.gov.uk.](mailto:ROringfencing@ofgem.gov.uk)	Added to Guidance
Ofgem should accept FDGs from a person established at least in the UK and EU, or, remove any location requirement as rating agency alone should be sufficient. It's possible that limiting the FDG to United Kingdom only undermines other legislation and further would not allow for a level playing field.	It is important that we ensure that the FDG is fully enforceable in the United Kingdom and the state the guarantor is registered in is an important element of this. However, we recognise that parent companies or counterparties can be located in economically stable countries with strong credit ratings and transparent regulatory regimes. the suppliers may lodge a Protection Mechanism with a person established in the UK or in EU states which are bound to apply the 2005 Hague Convention on Choice of Court Agreements.	Amended position
Clause 2(e) prohibits the guarantor from challenging any demand. The guarantor must have the ability to object to a demand if it is incorrect, for example if an incorrect amount is demanded or if the statement that a Non-Payment Event, Licence Event or Credit Event has occurred is factually incorrect. We recommend this clause to be deleted, or at the very least the guarantor must make the payment demanded but remains entitled to	For the good of the GB energy markets, the FDG is designed to put Ofgem in a position where it has legally equivalent protection to holding cash. To achieve this position, the FDG must be primary and autonomous. This is why the guarantor cannot challenge a demand. This does not affect the Licensee's right to challenge the Authority where it considers a sum has been demanded that should not have been.	No change to position

Issue raised	Our view	Outcome
seek a refund if it shown that the demand was flawed.		
The definition of "Credit Event": "winding -up" should be deleted: the 'frivolous or vexatious' threshold should apply to any third party insolvency proceedings against a Company. "and which is discharged…' should be amended to read "and/or…": a company needs to have an opportunity to respond to claims which are potentially unfounded before the Guarantee is called upon. "and, in any event, before it is advertised" should also be deleted. Again, if a claimant should advertise the fact that proceedings have been taken within the 10 day period, this wording effectively removes a Company's opportunity to respond to the claim.	These concerns are addressed in the revised definition of Credit Event, which now reads: "a liquidator, receiver, administrative receiver, administrator, special administrator, compulsory manager or other similar officer is appointed in respect the Licensee or any of its assets".	Templates amended
The definition of Expiry Date: "add "or (if earlier) the date notified to the Guarantor pursuant to Clause 4(a)" as Clause 4(a) allows the Beneficiary to notify the Guarantor if is being released at an earlier date; in clause 4(b), delete "on 23:59 (London time)" as this is inconsistent with the time of 5pm in the definition of Expiry Date".	There is no ambiguity in paragraph 4(a), which is addressing expiry otherwise than by elapse of time. We have amended the reference in paragraph 4(b) to 5pm London time.	Templates amended
The draft template of the First Demand Guarantee (FDG) states that the Guarantor will pay the Beneficiary within three working days of receipt of Demand. However, the template does not provide a definition of when a demand is deemed as received. We expect this to be made clear.	We have amended the templates to clarify this.	Templates amended

Issue raised	Our view	Outcome
We note that a demand for payment could be requested if the deadline for payment of 1 September is not met. The associated guidance, however, suggests that credit cover will only be drawn down where payments have not been made five working days before the late-payment deadline (31 October). Any demand for payment should be aligned with the late payment deadline stipulated in the RO Order.	The RO Order and RO(S) Order set out how the mutualisation amount will be calculated and do not provide Ofgem with any flexibility to take account of payments received after 31 October. The templates therefore define Non-Payment Event with reference to the 1 September payment date and allow Ofgem to draw down from 2 September. However, in practice, we do not intent to issue a demand until as close to the late payment deadline of 31 October but we will need to demand in sufficient time to ensure we receive the sums due before 23.59 on 31 October.	Definition of Non-Payment Event amended to 2 September but otherwise no change in position
For non-UK guarantors, bank holidays can be different between the countries and so (assuming English Bank Holidays take precedence in the FDG/PCG, which is certainly reasonable), 3 business days may not be practically possible on certain dates.	We proposed 3 rather than 5 business days to allow us to leave the demand as close as possible to the late payment deadline for RO.	No change to position
TRUST ACCOUNT		
Withdrawal of amounts from the account by the license holder – if a supplier withdraws amounts from the trust account in line with the deed (clause 2.3), then those amounts must cease to be Trust Property. The deed should expressly state that amounts withdrawn from the trust account in line with the deed cease to be Trust Property. Without an express clause, it could be interpreted that licensed suppliers need to seek a formal release each and every time that they seek to withdraw from the account in accordance with clause 2.3. An express clause is required to remove any room for confusion on this point.	We have amended clause 2.3.	Templates amended
In describing the Parties, the Authority is labelled as being the Beneficiary, but in the	The Authority is the Beneficiary for RO – references to other Beneficiaries were relevant to CCB ringfencing which is now subject to	Template amended

Issue raised	Our view	Outcome
definition of Beneficiaries, it is the Licensee and any future SoLR who are defined as being the Beneficiaries.	further consultation and have therefore been removed from the RO templates.	
"Non-Payment Event – this definition does not seem to allow for the grace period for payments to be made up to 31 October following the end of an obligation period. It uses 1 September as the due date for payment."	The RO Order and RO(S) Order set out how the mutualisation amount will be calculated and do not provide Ofgem with any flexibility to take account of payments received after 31 October. The templates therefore define Non-Payment Event with reference to the 1 September payment date and allow Ofgem to draw down from 2 September. However, in practice, we do not intent to issue a demand until as close to the late payment deadline of 31 October but we will need to demand in sufficient time to ensure we receive the sums due before 23.59 on 31 October.	Definition of Non-Payment Event amended to 2 September but otherwise no change in position