



# Consultation on financial monitoring framework

## Introduction

1. The Consumer Council for Water is the statutory consumer organisation representing water and sewerage consumers in England and Wales. The Consumer Council for Water has four regional committees in England and a committee for Wales. We welcome the opportunity to respond to Ofwat's consultation on its proposed financial monitoring framework.

## Executive Summary

2. The financial stability and sustainability of the water and wastewater sector is important to customers as service quality may suffer if there are risks to a company's ability to finance its functions. Transparency of companies' performance is also necessary so that customers and commentators on the industry can judge whether there is an appropriate balance of fair profits and prices to customers.
3. Therefore, we welcome the introduction of Ofwat's proposed financial monitoring framework as this should deliver
  - Greater transparency with regard to company financial structuring and performance; and
  - An assessment of how stable and sustainable company financial structures are, when measured against possible economic scenarios.
4. We broadly support the framework, including the proposed financial metrics to measure company financial results and structure, and Ofwat's intention to produce a 'user friendly' annual report for stakeholders, including customers.
5. Nevertheless, we would like to see the framework expanded to include
  - Further metrics to show actual company returns compared with the assumed level of return in the Final Determinations. This should give a picture of how well companies are performing against regulatory assumptions.
  - Special dividends made to shareholders and the reasons for them.
  - Company tax arrangements, including those with holding companies. This has been an issue of concern to customers and the media and would provide more transparency.
6. We also support Ofwat's suggestion that the framework could be extended to holding companies and retailers outside of the regulated incumbents to give a bigger picture of the financial stability and performance of the sector.
7. While we support Ofwat's intention to monitor companies' financial arrangements and performance, the paper is unclear about the actions and sanctions Ofwat could use if reporting reveals issues. We would welcome clarity on the options Ofwat has and would consider for regulatory intervention.

## Responses to Questions

1. **Do you think that the financial metrics we are proposing to include in our pilot financial monitoring report are appropriate measures?**

Those suggested are appropriate, to which we would add three more (see Q2 for details).

**2. Are there any other financial metrics that you consider should be included in the pilot financial monitoring report or that should be considered for future reports?**

We suggest three additional metrics:

- Comparison of actual gearing and returns with Final Determination assumptions. The metrics include some comparisons between actual company results and Ofwat's assumptions in the Final Determinations (e.g. revenue, earnings before interest and tax and profit after tax). We would welcome further comparators to cover gearing, and returns (on capital, regulated equity and RCV) to show actual returns compared to those assumed by the cost of capital set in the Final Determinations. This would provide the added benefit of showing how companies are performing against the assumptions made at the Final Determinations.
- Special dividends. We would like Ofwat to highlight report special dividends made to shareholders and the reasons for them.
- Tax. The monitoring framework is an opportunity to report on company tax arrangements, an area of concern for customers as reflected in media coverage. At present the metrics only require companies to report the tax charge for the year as a % of profit before taxation. However, in the paper Ofwat indicates that analysis of the initial pilot reporting could lead to a need to look further at tax structuring, including tax arrangements entered into with holding companies. We would welcome this added transparency.

**3. Do you agree that the financial metric definitions are appropriate?**

Yes, and we would welcome added definitions for the additional three metrics suggested in response to Q2.

**4. Do you agree that the financial monitoring report should be published each year with additional information being requested from companies only when required, or should we be asking all companies to provide financial information to us on a more frequent basis?**

We agree that annual reporting will be useful, and support Ofwat's intention to deliver a 'user friendly' report. We would like see such reports produce clear information on company financial structures and financial results in an understandable way for a varied 'audience', and would welcome Ofwat commentary to add context and highlight any trends or issues.

In terms of the frequency of reporting, we would welcome a risk based approach, where any companies that have issues relating to financial performance or risks associated with their financial structure, could be asked to submit relevant data more frequently. This should allow closer monitoring of how such risks are being managed and/or mitigated, with a return to annual reporting once such issues have been resolved.

**5. The financial monitoring report will focus on the regulated companies and their holding companies, including retailers. Are there any other companies that we should be including within the financial monitoring framework?**

We think the reports should also cover other retailers (non-incumbent associated retailers and new entrants) and infrastructure providers (e.g. Thames Tideway Tunnel) as this will

provide a more complete picture of the financial stability of the sector and greater transparency for customers.

6. **How far outside the regulatory ring fence do you think that we should be looking? Should the scope of the financial monitoring framework include more information in respect of principal holding companies, the ultimate controlling parties of the regulated or other key stakeholders?**

We would welcome the inclusion of information relating to holding companies (to give customers a fuller picture of the financial stability and the financial arrangements (including tax) between regulated companies and their 'parent' companies and shareholders.

7. **Do you agree we should be asking companies to carry our stress testing by way of sensitivities on their business plans, based on their actual capital structures and expenditure plans, and publish the results?**

Yes, if this provides assurance to customers that companies will be able to deliver services even when their financial stability is reduced. However, it is not clear how Ofwat will ensure companies' stress tests are carried out appropriately as the onus is on companies to do this and submit the results to Ofwat. We would welcome clarification on this point.

8. **Are there sensitivities proposed appropriate, or should we be asking companies to apply a different set of sensitivities?**

We consider that the sensitivities detailed in the paper are appropriate, as fluctuations in inflation and the cost of financing are scenarios that could have impacts on companies' financing and consequently service to customers. However, Ofwat should be minded to introduce further tests (or modify existing ones) should evidence from the markets and the wider economy justifies the need to test companies against other scenarios in the future.

## **Enquiries**

Enquiries about this consultation response and requests for further information should be addressed to:

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