



Financial Monitoring Framework Response
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Dear Sir

PRT response to Consultation on Ofwat's proposed Financial Monitoring Framework

Thank you for the opportunity to respond to the above consultation which was published on 7 July 2015. Our response should be read in conjunction to our response to Keith Mason's letter of 22 July 2015.

Overall whilst we very much support the desire to increase trust and confidence in the sector we would caution some of the recommendations in the paper, in particular that Boards undertake specific "stress testing," which appears counter to the recent progress achieved with Boards providing assurance on all issues, including fulfilling our duty to Ofwat under Condition F.

We believe that it is the responsibility of the Board to decide what are the important issues are for them and this recommendation appears to be a move away from the risk based regulation and a return to a more prescriptive approach. We shall address this issue in more detail in our response to Keith Mason, due on 7 August 2015.

There are 8 specific questions in the consultation and we have provided a comment against each of them as attached.

If you wish to discuss further, please do not hesitate to contact me.

Kind regards,

Neville Smith
Managing Director

PRT Response to Consultation on Ofwat's proposed Financial Monitoring Framework

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

The metrics in Appendix 1 appear appropriate to undertake the pilot study. In general these underpin the Final Determination and we report on many of these in our monthly management information.

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?

You could consider reporting the metrics as defined by the rating agencies, for example the definition of interest cover applied by Standard & Poors is subtly different to the measure as defined by Ofwat.

3. Do you agree that the financial metric definitions set out in appendix 2 are appropriate? Are there alternative definitions that we should be considering? If so, why?

The definitions provided in Appendix 2 are those applied in the Final Determination. As we note above some key stakeholders have variants on definitions and we would suggest discussing this issue with them in particular.

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 support the annual frequency of reporting. It appears appropriate given the financial stability of the sector. All companies have the option of advising Ofwat in a more-timely manner if there are issues arising within the year.

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?

No. If there is a particular issue or problem for any one Company, Ofwat could request that appropriate information is provided. For the majority of companies this will not be necessary.

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 companies or other key shareholders?

For most businesses the only body for which financial monitoring would be appropriate, in addition to the appointed business, would be at the group consolidation level. However, this would only be for certain ratios as many, for example those using RCV, would not be relevant. As noted above reporting on other group companies could be on an exception basis. Additional reporting should only be where there are specific concerns relating to company ownership and behaviours.

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

The Company already undertakes relevant stress testing as part of its regular discussions with ratings agencies and investors. We are not sure who else would benefit from the publication of these stress tests.

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

We suggest that the Company is best placed to establish the sensitivities to be tested as companies will best understand the risks they face.

The proposed sensitivities are unlikely to be relevant for all companies however they may provide a reasonable base line which can be added to as appropriate.