



South Staffs Water

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Financial Monitoring Framework Response,
Ofwat,
Centre City Tower,
7 Hill Street,
Birmingham,
B5 4UA

By email: FinanceAndGovernance@ofwat.gsi.gov.uk

3 August 2015

Dear Sirs,

South Staffs Water is pleased to submit our response to the consultation on Ofwat's financial monitoring framework.

We have a general concern over the publication of the Company's actual plan and hypothetical sensitivities around it. It represents significantly more disclosure than we do on a confidential basis to our lenders, ratings agencies etc.

We also believe that to put in place formal stress testing using specific sensitivities is taking the ownership of this away from the Board who, acting to fulfil its obligations under the Licence, should be free to undertake the assurance that they believe is appropriate.

The Company's response to the individual questions included in the consultation is set out below:

Q1 Do you think that the financial metrics we are proposing to include in our pilot financial monitoring report (see appendix 1) are appropriate measures?

There are 26 financial metrics listed in appendix 1 which is excessive. There were 8 financial ratios used in Company Final Determinations and 13 in the Ofwat financial model. It would therefore seem sensible to focus on a smaller list of targeted metrics. These metrics could be kept under review each year to determine if any should be added or deleted.

Q2 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?

The Company has not identified any other metrics that would need to be included in future reports that would be of use to stakeholders.

Q3 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?

It is important to ensure that the ratios are aligned as much as possible to other stakeholders' definitions, in particular the ratings agencies. If not, there is a danger that stakeholders may get confused or misinterpret the ratios.

Not all of the definitions refer to the appointed business which would extend the scope of the financial monitoring framework. In addition, for those definitions that use the Retail Prices Index (RPI) it should refer to whether it is average or year-end RPI.

Q4 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?

It would make sense to publish the report on an annual basis and should not create additional burden on companies as the data will be available from data already published.

South Staffs Water does not report interim financial information. If this was required, Ofwat would need to show there was a genuine reason for requesting it.

Any additional or more frequent information should only be requested from those companies who Ofwat believe they need additional assurance from. However, this should not necessarily be published.

Q5 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 do not believe that other companies should be included. The only situation where we believe that Ofwat would need to look beyond the regulatory ring

fence would be if there was a need to gain further assurance around companies' financial stability.

There seems to be little sense in extending this to retailers as there is potential cross over with the Certificate of Adequacy and the WSSL licencing regime. If such measures are needed then they should not be within this financial monitoring reporting which we believe will create confusion for users, and could create commercial risk for the Retailers, or even be a barrier to entry.

If retailers are ultimately included, new entrants should also have to adopt the financial monitoring framework so that everyone is on a level playing field.

Q6 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?

We do not believe that the scope of the financial monitoring framework should be extended further unless there is further assurance required around companies' financial stability. As set out elsewhere in our response, we believe it should be at the discretion of the Directors as to whether they need to look further at other parts of the Group in order to be able to give the required assurance. The structure of regulated companies' controlling parties is set out in the annual financial statements and in the corporate governance report. This should provide sufficient transparency to stakeholders where any financial risk has not been identified.

Q7 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 Directors currently sign off the capital adequacy statement in the F6 confirmations in the regulatory accounts and sign off a going concern statement in the statutory accounts. To put in place a formal way that they need to do this by specific sensitivities is taking the ownership of this away from the Board who should be free to undertake the level of assurance that they believe is appropriate.

We also believe that the results should not be published as it represents significantly more disclosure than we do on a confidential basis to our lenders, ratings agencies etc. The Board is duty bound to report to Ofwat any concerns over financeability and similarly Ofwat can raise any concerns they may have from any stress testing they may undertake.

Q8 Are the sensitivities proposed appropriate, or should be we be asking companies to apply a different set of sensitivities?

As we believe that the sensitivity analysis should be set by the Directors and not be published, the Company does not propose any other sensitivities that would be appropriate.

Yours faithfully,

Philip Saynor,
Director of Finance and Regulation
South Staffordshire Water PLC