

**Board leadership, transparency  
and governance – holding  
company principles**

## About this document

This document sets out a series of principles that we consider should guide the governance arrangements of the holding company of a regulated company operating in the water sector in England and Wales. These principles complement [those we have published for the regulated companies](#).

The coverage of these principles is limited to those areas where we consider that the activities of the holding company could impact on the regulated company's ability to meet its obligations. We recognise that the governance arrangements of a holding company will cover a far wider range of activities than are included here.

Most of the water companies have an obligation upon them to make sure the regulated company board is composed in such a way that the directors are able to act independently of the parent company; and that where potential conflicts exist between the interests of the regulated company as a water undertaker and those of other group companies (including holding companies), the regulated company and its directors must ensure that, in acting as directors of the regulated company, they should have regard exclusively to the interests of the regulated company.

The principles reflect these obligations and it is for each company and the group to which it belongs to describe how they meet these principles.

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## 1. Summary

Following on from Jonson Cox's '[Observations on the regulation of the water sector](#)' in March 2013, Ofwat has engaged with companies and their investors to understand how we can provide confidence that the water sector in England and Wales operates to high standards of board leadership and governance. As a result of this constructive engagement, we are already seeing improvements to the transparency and extent of disclosures in companies' annual reports.

We published our draft principles for holding companies in January 2014. We welcome the constructive and positive responses we received to the principles and the commitment to high standards of board leadership and governance that we heard from companies' owners. There were very few comments on the principles themselves and as a consequence we have made limited changes.

We have also published principles on [board leadership, transparency and governance that apply to each regulated company](#). We are pleased that each regulated company has developed a code that sets out how it will meet the principles.

Governance issues currently have a high profile in the media and with the public. They have also been highlighted by the UK Government – for example, as a policy focus for the Department for Business, Innovation and Skills. There is an expectation that companies will operate high standards of governance and transparently demonstrate that they do so. Water companies provide an essential public service and need to maintain legitimacy among their customers and stakeholders more generally. Confidence in the sector is strongly influenced by the way in which the sector is perceived. Trust is hard won but easily lost, and trust can be built by demonstrating exemplary practice in terms of governance and disclosures.

The regulated company principles put the onus on the regulated company to demonstrate certain behaviours in relation to its interaction with its holding company. However, we recognise that for the regulated company to operate to the highest standards, the holding company needs to do so too.

Investors have a clear and legitimate role to play in running the business of the regulated company through the holding company. For example, we acknowledged in our regulated company principles that investors have a legitimate place on the board of the regulated company. Publications and guidance such as the 'UK Stewardship Code' and the ABI's 'Improving Corporate Governance and Shareholder

Engagement' set out the roles of investors and identify good practice. The regulated company is providing an essential public service for which most customers are not able to choose their supplier. Customers and regulators have high expectations of the standard of disclosures and behaviours of the companies, and the groups to which they belong, in this sector. We see the involvement of investors as beneficial to ensuring that regulated companies are protected from any adverse impacts from the group structure of which they are a part.

This document includes the principles which we think each holding company should consider adopting voluntarily in order to demonstrate that it is operating to the highest standards. This is particularly in relation to the interactions which it has with the regulated company.

These principles set out for existing and potential investors our expectations of investors in a monopoly public service company. Fully implementing the principles and transparently demonstrating that this is the case will allow the sector to demonstrate that it recognises and fully meets the responsibilities that come from providing an essential public service.

We will examine the way in which the regulated companies and their holding companies adhere to these principles and will step in where we consider that there are failures in disclosure or that the principles are not being met.

## 2. Existing licence and other requirements

The licence conditions that most of the regulated companies already have in place recognise the importance of the role and responsibilities the holding company has in relation to the operation of the regulated company. Most companies are required by condition P of their licence to obtain legally enforceable undertakings from their ultimate controller(s) that they will:

- provide the regulated company with all the information it needs to comply with its obligations under the Water Industry Act 1991 or its licence;
- refrain from any action which would or may cause the regulated company to breach any obligations under the Water Industry Act 1991 or its licence; and
- ensure that there are no less than three independent non-executive directors on the regulated company's Board.

The 'Ultimate Controller' is defined in the licence as "any person who or which (alone or jointly with others and whether directly or indirectly) is (in the reasonable opinion of the Water Services Regulation Authority) in a position to control, or to exercise material influence over, the policy or affairs of the regulated company or of any holding company of the regulated company".

These principles do not place requirements on a holding company that are any more onerous than what is currently implied by the undertakings which a regulated company is required to secure from the ultimate controller.

In some cases the holding company may already be required to adhere to certain guidelines – for example, the 'Guidelines for Disclosure and Transparency in Private Equity'; our principles are intended to complement rather than duplicate existing requirements.

In addition, the 'UK Stewardship Code' sets out principles for institutional investors in the UK of listed companies to follow, and describe practices which private companies may wish to consider and adopt, where relevant.

### 3. Principles

These principles complement those for the regulated company. The coverage of the principles is limited to those areas where we consider the activities of the holding company could have the greatest direct impact on the regulated company.

The principles cover the following areas.

- Transparency.
- Risk.
- Long-term decision making.

For the purposes of these principles, we define the holding company as the company which the regulated company states in its accounts to be its ultimate controller (and any intermediate companies between it and the regulated company). We expect to see transparency about group structures and how the holding company fits within any such group and how it meets the principles.

The holding company, together with the regulated company, can decide how best to make the disclosures which we have set out below but should consider how they can be made easy to find and presented in an accessible form. The disclosures could, for example, be made in the regulatory accounts or annual report of the regulated company.

We are looking for a self-regulatory approach and a leading holding company may choose to set out clearly in a code how it meets our principles. Where a holding company does not meet a principle which we have set out, it may instead choose to provide an explanation of why that is the case and the approach that it has taken to meeting the spirit of the proposals. The holding company will need to consider the principles and suggested disclosures in the context of its particular structure.

The principles represent the minimum that we consider should apply to any holding company operating in this sector.

## **1. Transparency – the key to maintaining customer legitimacy and confidence**

### **1.1 The holding company structure should be transparent, and explained in a way that is clear and simple to understand**

#### **Why?**

Some of the regulated companies operating in the sector are members of larger group structures that can be complex and difficult to understand. The UK Government has highlighted the importance of clarity in the reporting of group structures. Responsible owners of companies providing a public service should ensure that their group structures are fully explained in a way that sets out where ownership and accountability lies, and who has an economic interest in the business.

As we have set out in our recently published principles for regulated companies, opaque structures can damage the legitimacy of the regulated company and the sector as a whole.

#### **How?**

As we explain in our principles for regulated companies, the place of the regulated company within the group structure should be clear and straightforward to understand and readily accessible. It should also be clear which company is the holding company. Any areas that lack clarity should be explained.

The role of each of the companies that have links or interests in the regulated company within the group structure should be clearly explained, including a description of the interaction between the holding company and the regulated company. It should also be clear in which country each company is registered. In the event of a group company being dormant/non-trading, this should be clearly stated.

There should be no hidden beneficiaries of the regulated company within the structure – the investors in the holding company should be clearly set out.

### **1.2 The holding company will provide information on debt and equity structures**

#### **Why?**

Transparent structures will help build trust and increase legitimacy with customers and other stakeholders.

Both the regulated company and the holding company have a responsibility to provide information that is available to customers that sets out these structures in a comprehensive and comprehensible way.

#### **How?**

The holding company should publish information in an accessible way to make its debt and equity structures transparent and explain where and why it has considered it necessary to exclude any information (for example, for reasons of commercial confidentiality). This may also need to cover the capital structure of any other company with links to or interests in the regulated company if this assists transparency.

### **1.3 The holding company will transparently demonstrate directors' interests and the nature of those interests (other than where they are declared at the regulated company level)**

#### **Why?**

Although we expect the board of the regulated company to operate independently, there will be some circumstances in which the board of the holding company will make decisions that affect the regulated company. Therefore, it is reasonable for customers and other stakeholders to have information about the holding company board members. For example, it would be of interest to stakeholders if a director holds more than one position in the group.

#### **How?**

The holding company should publish a list of all its directors and have a clear process for disclosure of any interests of those directors in other companies within the group including the regulated company at least annually (other than where they are declared at the regulated company level).

### **1.4 The holding company will explain which matters that impact on the regulated company are reserved to the holding company board**

#### **Why?**

We recognise that there will be some matters at the regulated company level (for example, a decision to appeal a price control determination) in which the holding company will wish to reserve the right to be involved. However, it needs to be clear which matters these are so that stakeholders can see that they are appropriate and that the board of the regulated company is leading the business, both in terms of accountability and legitimacy.

#### **How?**

As we explain in our regulated company principles, reserved matters should be clearly explained and disclosed, for example in its code, annual report or on its website.

### **1.5 The holding company will transparently demonstrate the governance standards that it applies, including how it meets these principles**

#### **Why?**

The governance standards of companies are under the spotlight, both at a UK level and internationally. As the owner of a monopoly company providing a public service, a holding company has a responsibility to be at the forefront of the move to greater openness and the pursuit of best practice in corporate governance. A holding company can demonstrate its commitment to this by developing its own corporate governance code.



### **How?**

We expect the holding company to demonstrate how it reviews corporate governance standards and makes the necessary changes to ensure that its approach aligns with current best practice. Any material changes to corporate governance that have taken place in the preceding year should be reported annually.

The holding company should address each of the principles set out in this document stating how they have been met. We expect a thorough explanation if exceptionally a particular principle is not met, in its annual report or on its website.

## **2. Managing risk – the holding company will manage its risks in such a way that the regulated company is protected from risk elsewhere in the group**

### **2.1 The holding company will not put the obligations and requirements of the regulated company at risk**

#### **Why?**

We expect the regulated business to be protected from risks in other parts of the group, so that the customers of the regulated company are not subject to service or cost issues as a result of activities elsewhere in the group. There are licence obligations in place that place a ring-fence around the regulated company. Therefore, we expect the holding company to be mindful of these obligations and take steps to ensure that its activities (or those of subsidiary companies in the group) do not negatively impact on the regulated company's ability to meet its obligations.

#### **How?**

In carrying out its activities the holding company will ensure that it fully understands the duties and obligations of the regulated company contained within statute and its licence. It should give full consideration to the undertaking required by condition P of the regulated company's licence ('condition P undertaking') – including that it refrains from any action which would cause the regulated company to breach any of its obligations. The holding company should explain how it has ensured that it has a full understanding of the duties and obligations of the regulated company and has given full consideration to the condition P undertaking.

### **2.2 The holding company should provide the regulated company with the information that it reasonably requests about the activities of the wider group**

#### **Why?**

The regulated company should have access to the information that it legitimately needs about the wider group to assure itself that it is not at risk from activities elsewhere within the group. This includes a clear understanding and visibility of matters where they have the potential to impact on the regulated company. For example, this may include the shareholder agreement or the financing, strategy and management of the wider group.

### **How?**

The holding company should provide the regulated company with relevant information. Where the regulated company determines it needs additional information, clarification or explanation this should be made available to it.

### **2.3 The holding company should disclose any issues at the group level which may materially impact on the regulated company**

#### **Why?**

This demonstrates that the holding company fully understands the obligations and requirements of the regulated company (as it must do to comply with the condition P undertaking) and takes them into account in decisions that are taken at boards of companies that sit above the regulated company board. It demonstrates that the holding company has fully considered both its exposure to risk and in turn whether these may expose the regulated company to material risk.

#### **How?**

The holding company should explain how it will identify and disclose such issues where they are identified (or confirm that there are none). We expect this information to be disclosed transparently and the consideration of issues to identify any immediate impacts as well any potential negative impacts to the long-term future of the regulated company – for example, in its annual report or on its website.

### **2.4 The holding company should support the Board of the regulated company so that it is able to run the business as if it is a separate and listed public limited company**

#### **Why?**

The board of the regulated company needs the resources and managerial expertise required to allow the business to provide the services that it is licensed to carry out for its customers. This needs to be sufficient to make sure that the regulated company is fully equipped to meet its obligations.

#### **How?**

We expect the holding company to facilitate the ability of the regulated company to meet (or by exception explain any departures from) the principles that Ofwat has set out for regulated companies ('Board leadership, transparency and governance – principles'). This includes the composition of the board of the regulated company.

### **3. Supporting long-term decision making**

#### **3.1 The holding company should support the regulated company in operating in a sustainable way (including making long-term decisions) in line with the long-term nature of the water sector**

##### **Why?**

The long-term provision of a public service is an important focus for the regulated company and it should be in a position to meet the medium to long-term challenges which it faces (for example, population growth, climate change).

##### **How?**

The holding company should support the regulated company so that it can make strategic and sustainable decisions in the interests of the regulated business for the long term.



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