



Demonstrating Financial Resilience Consultation Response
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15 February 2016

Dear Sir

PRT Response to Ofwat Consultation on how companies should demonstrate long term financial resilience

Thank you for the opportunity to comment your consultation, published on 27 January 2016, on how companies should demonstrate long term financial resilience. We give our consent that our response is placed in the public domain, if appropriate.

We appreciate that feedback provided through the workshop process has been carefully considered in preparing the proposed approach.

As an overall principle we concur that Board reporting in this area should be addressed via the UK Corporate Governance (“the Code”) requirement for a “viability statement”.

In particular we feel that the reliance on Companies’ Boards to take overall responsibility for the approach to disclosure of “financial resilience” is consistent with Ofwat’s current move away from an ex ante regulatory regime.

However, we also highlight that, the proposed approach for reporting of “financial resilience”, to be addressed via the UK Corporate Governance “viability statement”, should remain wholly consistent with the requirements of the Code and emerging market best practice and not be subject to additional mandatory requirements.

Looking at your three questions in turn:-

Q1 Do you agree that the proposed approach to companies demonstrating their financial resilience will provide an appropriate level of assurance about each company’s long term financial resilience?

In overarching terms we concur with the proposal that the UK Corporate Governance requirement, for a viability statement, appropriately addresses the demonstration of financial resilience. In broad terms our preference would be that Ofwat do not mandate specific

disclosures as part of the viability statement. Instead Companies should be permitted to apply the provisions of the Code and market practice. If, after the first annual reporting cycle, Ofwat's view is that the approach taken by the industry is inadequate, then further guidance could be issued.

In terms of the specific proposals as drafted, in our view there are a number of areas of Ofwat's specific guidance which appear inconsistent with the requirements of the Code and emerging market practice. We have summarised our concerns as follows;

1) *Board statement that they consider the company is "financially viable"*

The Appendix 1 on pg. 13 of the consultation document references Company Boards should;

"..include an explicit statement...that they consider that the company is financially viable"

This presents our area of greatest concern. The Code requires that;

"The directors should state whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, drawing attention to any qualifications or assumptions as necessary."

The statement required by the Code appears significantly less onerous than the statement proposed by Ofwat (that the company is "financially viable"). The proposed wording is also a divergence from market practice where, without exception, the wording used to date follows the Code precisely. If the proposed wording is implemented as drafted Boards may need to seek advice as to the appropriateness of this specific wording and the potential implications in terms of Board and Corporate responsibility.

Accordingly, if it is the intention that the terminology used in Appendix 1 is applied, we strongly disagree with the proposed statement as it is drafted. We would suggest that this point would be better addressed by reflecting the precise wording set out in the Code.

2) *Mandating the detailed disclosures around "scope of sensitivities", "appropriateness of sensitivities"*

The proposals for the provision of "*a detailed explanation*" (section 5 pg. 11) in relation to the sensitivities selected appears inconsistent with the provisions of the Code, market practice and the principle that this disclosure is based upon the judgement of the Board. It would appear more proportionate that the disclosure made would be based on those areas considered significant by the Board, in reaching its conclusion.

3) *Implied length of the future period of assessment*

Whilst in one area the consultation makes it clear that Ofwat do not intend to specify the period of any assessment, wording elsewhere implies that a period beyond the current AMP would be anticipated "*the company's management have considered the longer term viability of the company both within and beyond the then current price control period*". We would value confirmation that this is not the intention.

Q2 Is there anything else that we should be recommending that companies explicitly include in their statement on long term financial viability?

As we have noted above, we feel that the specific disclosures included in the viability statement should not be mandated by Ofwat. Instead we would propose that disclosure should be;

- a) The sole responsibility of the Board based on each Company's specific circumstances and the Board's own judgement.
- b) Consistent with the requirements of the UK Governance Code; specifically not requiring more detailed disclosure or divergent wording.
- c) Consistent with market practice. If after the first reporting cycle, Ofwat feels that Company reporting has not met the spirit of the Code or appropriate market practice, then further guidance could be issued.

Q3 Are there alternative approaches to companies demonstrating their long term financial resilience that Ofwat should be considering?

No. In our view there are a number of existing measures which we believe adequately address the need for and the demonstration of financial viability including;

- Specific licence condition F6A.
- The requirement for investment grade credit ratings
- Existing Companies' Act, Accounting Standard and UK Corporate Governance requirements.

Please contact me if you wish to discuss any of the issues raised in our response further.

Yours faithfully,



Helen Orton
Finance and Regulation Director