

Consultation by Ofwat on how
companies should demonstrate
long term financial resilience

Southern Water's Response

25 February 2016

Southern Water's response to the Consultation by Ofwat on how companies should demonstrate long term financial resilience

Thank you for your letter. We have read your recent consultation on how companies should demonstrate long term financial resilience.

Southern Water fully supports your vision of trust and confidence for the sector and we understand how important financial resilience is in delivering this vision.

We have set out our answers to your specific questions below.

Question 1 – 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?

We welcome the proposed approach. We believe it will be an effective and proportionate approach to ensuring that Ofwat and other stakeholders have appropriate assurances as to the financial resilience of companies. We would, however, emphasise that while the proposed approach increases transparency and provides a common framework, it does not alter the significant work that the company would be doing, in any event, to ensure its long term financial resilience. Our Board and Executive Management are continuously monitoring the principal risks faced by the business and responding accordingly. This work is further augmented by the third party assessments of our credit rating agencies and our auditors.

We would like to confirm our understanding of the term "Third Party Assurance" in Appendix 1. Ultimately we consider the viability statement to be the responsibility of our Board. As such, we do not consider it necessary to specify the need for specific third party assurance. In our case, we already have: an assessment of our business plan as part of our rating by three credit rating agencies; a Board approved business plan for the Asset Management Period; enterprise wide risk management reporting; an independent internal audit function; and an annual statutory audit. There is a risk that by mandating specific third party assurance of the viability statement, this exercise turns into a one size fits all compliance exercise, rather than a truly Board-owned assessment of viability.

To avoid repetition in our Annual Performance Report, which will be in the same document as our statutory accounts we would seek to rely on RAG 3.08. Specifically, as per 2.2.3, we would propose to cross reference the viability statement contained in our statutory accounts rather than duplicate the section. We would of course ensure that this was done in a clear manner.

Question 2 – Is there anything else that we should be recommending that companies explicitly include in their statement on long term financial viability?

No.

Question 3 – Are there alternative approaches to companies demonstrating their long term financial resilience that Ofwat should be considering?

We support the proposed approach but we would consider it part of a broader range of measures available to assess financial resilience. Some examples include: credit ratings, which are another good measure of long term financial resilience as they apply to our rated bonds with tenors well in excess of 10 years; our Whole Business

Securitisation has significant covenants and notification requirements intended to safeguard the financial viability of the business. (As an example, we have lock up covenants that would prevent equity distributions being paid should our leverage be above a certain level.)