

April 2019

Trust in water

**PR19 draft determinations:
Severn Trent Water – Securing
confidence and assurance actions
and interventions**

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PR19 draft determinations: Severn Trent Water - Securing confidence and assurance actions and interventions

Following our initial assessment of plans, we categorised two types of actions for fast-track companies:

- agreed actions that fast-track companies committed to implement to ensure that their plans meet the threshold for fast-track status; and
- required actions for companies which in general were required for draft determinations (or final determinations for some aspects of past delivery).

Table 1 below sets out the agreed and required actions, a summary of the company's response to the action, our assessment of the company's response, and any further interventions we are making as part of the draft determination.

Each action has a unique reference. The prefix 'SVE' denotes the company Severn Trent Water. The central acronym references the test area where the action has been identified, please see the 'PR19 draft determinations: Glossary' for a key of these acronyms. Actions whose numbers are preceded with an 'A' denote agreed or required actions.

Table 2 below sets out any further interventions that are not resulting from an action, which we are making as part of the draft determination.

Each further intervention that is not resulting from an action has a unique reference. The prefix 'SVE' denotes the company Severn Trent Water. The central acronym references the test area where the action has been identified, please see the 'PR19 draft determinations: Glossary' for a key of these acronyms. Intervention numbers are preceded with a 'C'.

For all other documents related to the Severn Trent Water draft determination, please see the [draft determinations webpage](#).

Table 1: Severn Trent Water's response to required actions and interventions for draft determinations

Test area	Action reference	Action type	Action	Date required	Summary of the company's response to the action	Our assessment and rationale	Interventions
Securing confidence and assurance	SVE.CA.A1	Agreed	The company has not included our default gearing outperformance benefit sharing mechanism in its plan. Although the company does not forecast gearing to exceed 70%, the company should confirm it will apply the default sharing mechanism from 'Putting the sector in balance' into its published business plan, so that customers will receive bill reductions if gearing in any year is above the 70% threshold.	10am, 11 February 2019	Severn Trent Water's response addresses the action raised. Severn Trent Water confirms that it is committed to adopting our default sharing mechanism from 'Putting the sector in balance.'	No intervention required. Severn Trent Water has complied with the action.	N/A

Test area	Action reference	Action type	Action	Date required	Summary of the company's response to the action	Our assessment and rationale	Interventions
	SVE.CA.A2	Agreed	<p>On dividend policy the company should confirm that it is committed to adopt the expectations on dividends for 2020-25 as set out in 'Putting the sector in balance' to include:</p> <ul style="list-style-type: none"> • Provide an updated dividend policy that includes a specific reference to pension obligations. • Clear Board commitment to publish detail on dividend policies in the APR and to signal changes to stakeholders. • Commitment to transparency about how the dividend policy in 2020-25 takes account of obligations and commitments to customers for the dividend policy that is applied in 2020-25 and when determining dividends. <p>Please provide an update on the steps you are taking to fully meet the expectations as set out in our 'Putting the sector in balance' position statement.</p>	10am, 11 February 2019	<p>Severn Trent Water updated its AMP7 dividend policy to include a reference to pension obligations. It also provides sufficient evidence of its intention to publish detail on dividends and signal changes ("our APR will explain how the dividends we propose and pay are consistent with our dividend policy. We will also explain any change to our policy and the judgements the Board has made in making that change.")</p> <p>Severn Trent Water confirms that when considering dividends, its Board will have regard to performance across its obligations and customer ODIs. However, Severn Trent Water provides no detail on which obligations or commitments will be considered or how they will be considered.</p>	<p>Intervention required.</p> <p>Severn Trent Water provides sufficient evidence of its intention to meet the expectations on dividends as set out in 'Putting the sector in balance' but its response lacks evidence on how it will demonstrate annually to stakeholders that it has met them.</p> <p>We set out Severn Trent Water's commitments in our draft determination and set a clear indication that we expect companies to apply the 'Putting the sector in balance' proposals in full in 2020-25.</p>	We look to Severn Trent Water to provide a clear commitment to transparency about how the dividend policy in 2020-25 takes account of obligations and commitments to customers for the dividend policy that is applied in 2020-25.
	SVE.CA.A3	Agreed	<p>On executive pay the company should confirm it is committed to adopt the expectations on performance related pay for 2020-25 as set out in 'Putting the sector in balance' to include:</p> <ul style="list-style-type: none"> • Providing full details and commitment to publish, including all performance metrics, the executive pay policy for 2020-25. • Visibility and evidence of substantial linkage of executive 	10am, 11 February 2019	<p>Severn Trent Water states that it is committed to being a role model for private companies that deliver public services. It understands that this means leading the way on remuneration as well as delivering sector leading performance on key operational and financial metrics such as costs and ODI's.</p>	<p>No intervention required.</p> <p>Severn Trent Water's policy demonstrates the company's commitment to move in the direction of the expectations set out in 'Putting the sector in balance'</p> <p>We expect Severn Trent Water to show that its policy demonstrates a substantial link to stretching performance delivery for customers through 2020-25. Also</p>	We expect the company and its remuneration committee to ensure executives have stretching targets linked to performance delivery for customers. We expect the company to be transparent about further updates to the development of its policy that will apply in 2020-25.

Test area	Action reference	Action type	Action	Date required	Summary of the company's response to the action	Our assessment and rationale	Interventions
			<p>remuneration to delivery to customers.</p> <ul style="list-style-type: none"> • Clear explanation of stretching targets and how they will be applied. • Clear explanation of how the policy will be rigorously applied and monitored. • Commitment to report how changes, including the underlying reasons, are signalled to customers. <p>Please provide an update on the steps you are taking to fully meet the expectations as set out in our 'Putting the sector in balance' position statement.</p>		<p>Severn Trent Water proposes that:</p> <ul style="list-style-type: none"> • The annual bonus will be based on 51% weighting allocated to customer and environmental based ODI objectives and health and safety performance and 49% weighting to profitability measures. • The long term incentive plan will continue to be based on upper quartile RoRE performance, meaning that management must deliver both best service and cost performance. • It is committed to continue publishing full details of the targets, achievement against them and performance narrative, for both LTIP and the Annual bonus scheme. It is also committed to engaging with shareholders regarding any proposed changes to design or performance metrics. 	that the company is transparent about further updates to the development of its policy that will apply in 2020-25.	
	SVE.CA.A4	Required	In App1 we identified some validation errors such as changes from % to MI/day and text to numbers (for sewer collapses, mains bursts, leakage, and PCC). Also deadbands / caps / collars not inputted - breaks the max payments formula. The company should review and address these issues.	10am, 11 February 2019	Severn Trent Water's response addresses the action raised with the exception of sewer collapses. In its response Severn Trent Water continues to pledge 'stable performance' for sewer collapses from 2018-19 onwards.	Partial intervention required. Severn Trent Water retains its business plan qualitative service levels for sewer collapses PC and provides insufficient justification of its decision.	We are intervening to set numerical levels for sewer collapses PC. We are setting the levels for each year in the 2020-25 period at 2017-18 level that Severn Trent Water provides within App1 in recognition of its 'stable performance' pledge.

Test area	Action reference	Action type	Action	Date required	Summary of the company's response to the action	Our assessment and rationale	Interventions
	SVE.CA.A5	Required	The company should explain the assurance process it has taken to develop its tax forecasts to demonstrate that amounts proposed for tax take account of customer interests, in particular to clarify the scope of the assurance work that was undertaken and the outcome of that work.	10am, 11 February 2019	Severn Trent Water provides a letter of assurance from PWC which summarises the scope of the work performed. The letter confirms that judgements, assumptions and methodology were considered and confirmed to be reasonable.	No intervention required. Severn Trent Water provides sufficient evidence of its assurance process on the tax forecasts and has complied with the action.	N/A

Table 2: Further interventions for draft determinations

Intervention reference	Our assessment and rationale	Interventions
No further interventions for Severn Trent Water.		

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a trusted and respected regulator, working at the leading edge, challenging ourselves and others to build trust and confidence in water.

Ofwat
Centre City Tower
7 Hill Street
Birmingham B5 4UA

Phone: 0121 644 7500
Fax: 0121 644 7533
Website: www.ofwat.gov.uk
Email: mailbox@ofwat.gsi.gov.uk

April 2019

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