

April 2019

Trust in water

**PR19 draft determinations:  
South West Water – Securing confidence  
and assurance actions and interventions**

## PR19 draft determinations: South West 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 'SWB' denotes the company South West 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 'SWB' denotes the company South West 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 South West Water draft determination, please see the [draft determinations webpage](#).

**Table 1: South West 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	SWB.CA.A1	Agreed	South West Water has not included the 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: position statement on PR19 business plans' 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	South West Water forecasts gearing over the 2020-25 period in the range 63.7% to 62.1% based on the actual structure in the PR19 Business Plan submission in September 2018. Whilst this forecast is significantly below the level noted within the gearing outperformance benefit sharing mechanism outlined in Ofwat's 'Putting the sector in balance,' South West Water is committed to implementing the	No intervention required.  South West 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
					default gearing benefit mechanism if gearing is above the 70% threshold.		
	<b>SWB.CA.A2</b>	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"> <li>• Clear Board commitment to publish detail on dividend policies in the APR and to signal changes to stakeholders.</li> <li>• 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.</li> </ul> <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>South West Water provides sufficient evidence of its intention to publish detail on dividends and signal changes stating that it is "committed to ensuring that our reporting of the policy is clear and transparent and links delivery for customers and ongoing obligations (performance) directly to the dividends paid."</p> <p>South West Water confirms that when setting dividend payments, its Board will consider if the company has delivered on its commitments to customers. However, South West Water provides no detail on which obligations or commitments will be considered or how they will be considered when determining dividends.</p>	<p>Intervention required.</p> <p>South West Water provides sufficient evidence of its intention to meet the expectations on dividends set out in the 'Putting the sector in balance' position statement but its response lacks evidence on how it will demonstrate annually to stakeholders that it has met them.</p> <p>We set out South West 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>	<p>We look to South West 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. We expect the company to provide an update on these issues in response to our draft determination.</p>
	<b>SWB.CA.A3</b>	Agreed	<p>On executive pay, the company should confirm that 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"> <li>• Providing full details and commitment to publish, including all performance metrics, the executive pay policy for 2020-25</li> <li>• Visibility and evidence of substantial linkage of executive remuneration to delivery to customers</li> </ul>	10am, 11 February 2019	<p>In addition to the IAP response, South West Water provided further correspondence on its proposed policy for 2020-25.</p> <p>South West Water states that it is committed to meet the expectations set out in our 'Putting the sector in balance' position statement.</p>	<p>No Intervention required.</p> <p>South West Water states that it is committed to adopting the proposals for performance related executive pay.</p> <p>The 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 understand that there remain a number of details to be finalised, for example how targets are to be set and to demonstrate how they will deliver stretching performance for customers through 2020-25.</p> <p>We expect the company and its remuneration committee to ensure executives continue to have stretching targets linked to performance delivery for customers. We expect the</p>

Test area	Action reference	Action type	Action	Date required	Summary of the company's response to the action	Our assessment and rationale	Interventions
			<ul style="list-style-type: none"> <li>• Clear explanation of stretching targets and how they will be applied.</li> <li>• Clear explanation of how the policy will be rigorously applied and monitored.</li> <li>• Commitment to report how changes, including the underlying reasons, are signalled to customers.</li> </ul> <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>South West Water proposes that:</p> <ul style="list-style-type: none"> <li>• The annual bonus will be based on (i) 70% weighting linked to specific customer delivery targets, underpinned by an expectation that performance related pay will be made only if at least 90% of a basket of ODIs to customers are met, (ii) 10% weighting to personal objectives, including delivery of the 'New Deal', and (iii) 20% weighting linked to financial delivery targets that support financial sustainability (10% Profit before tax and 10% net debt / gearing).</li> <li>• The long term incentive will apply equal weighting to (i) RoRE outperformance (based on the Final Determination), (ii) sustainable dividend measures and (iii) C-Mex. An underpin applies which will allow the Remuneration Committee to reduce or withhold vesting if it is not satisfied with the underlying operational and economic performance of the company. Malus and clawback arrangements will also be in place.</li> </ul> <p>South West Water states that the South West Water Remuneration</p>	<p>We expect South West Water to show that its policy demonstrates a substantial link to stretching performance delivery for customers through 2020-25. Also that the company is transparent about further updates to the development of its policy that will apply in 2020-25.</p>	<p>company to be transparent about further updates to the development of its policy that will apply in 2020-25..</p>

Test area	Action reference	Action type	Action	Date required	Summary of the company's response to the action	Our assessment and rationale	Interventions
					<p>Committee will oversee in the first instance the monitoring and application of its Executive Pay policy, with the potential from 2020 of the Independent Customer Challenge Panel having role in monitoring the policy.</p> <p>In addition to reporting through the annual report and accounts, information will be disseminated to the Customer Challenge Panel, through a customer oriented document.</p>		
	<b>SWB.CA.A4</b>	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	South West Water provides further detail on the work performed by Chandler KBS on capital allowances. South West Water confirms that the other tax inputs have been assured by KPMG and provides detail on the work performed, which includes reviewing commentary and confirming consistency with methodology.	<p>No intervention required.</p> <p>South West Water has complied with the action.</p>	N/A
	<b>SWB.CA.A5</b>	Required	<p><b>WaterShare.</b> The company should publish information that explains the following elements of WaterShare:</p> <ul style="list-style-type: none"> <li>its governance and decision-making arrangements; and</li> <li>how it will calculate any amount to be shared (including the stated £20 million outperformance sharing on the cost of embedded</li> </ul>	10am, 11 February 2019	<p>South West Water explains some elements of its governance and decision making arrangements for the existing mechanism in the PR14 period and provides detailed calculations of the mechanism.</p> <p>South West Water does not commit to annual reporting on</p>	<p>Intervention required.</p> <p>South West Water does not provide sufficient detail on the governance arrangements which will apply for sharing payments made under WaterShare in the period 2020-25.</p>	South West Water should, in its response to its draft determination, set out how it will allocate sharing payments (including the role of customer preferences) and how it will report the amounts distributed. Its business plan submissions only explain how its governance process works for the current control period.

Test area	Action reference	Action type	Action	Date required	Summary of the company's response to the action	Our assessment and rationale	Interventions
			debt) and report its annual decisions.		how much of the £20 million outperformance benefit it has shared.		

**Table 2: Further interventions for draft determinations**

Intervention reference	Our assessment and rationale	Interventions
There are no further interventions for South West 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.

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