

July 2019

Trust in water

# PR19 draft determinations

**Hafren Dyfrdwy – Securing confidence and assurance actions and interventions**

## PR19 Draft Determinations: Hafren Dyfrdwy – Securing confidence and assurance actions and interventions

Following our initial assessment of plans, we categorised two types of actions for slow-track and significant scrutiny companies:

- required actions for companies which in general were required for draft determinations (or final determinations for some aspects of past delivery); and
- advised actions for companies to do by a specific date but that are not required for our draft determinations.

Table 1 below sets out the required and advised 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 ‘HDD’ denotes the company Hafren Dyfrdwy. The central acronym references the test area where the action has been identified, please see the ‘PR19 draft determinations: Glossary’ for a key to these acronyms. Actions whose numbers are preceded with an ‘A’ denote required actions and actions whose numbers are preceded with a ‘B’ denote advised 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 ‘HDD’ denotes the company Hafren Dyfrdwy. The central acronym references the test area where the action has been identified, please see the ‘PR19 draft determinations: Glossary’ for a key to these acronyms. Intervention numbers are preceded with a ‘C’.

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

**Table 1 – Hafren Dyfrdwy’s response to required actions and interventions for draft determinations**

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
Securing confidence and assurance	HDD.CA.A1	Required	Provide restated Board assurance that the Board will monitor delivery of its outcomes to ensure they meet its relevant statutory and licence obligations and has explained how it will do this. The original submission contained a statement within the main business plan document, for which there was insufficient evidence that it was made by the Board.	1 April 2019	Hafren Dyfrdwy’s Board provides the following updated Board assurance statement: "As a Board we want to deliver the best outcome for our customers. We consider our performance commitments to be a critical part of this and will ensure transparency and confidence in our data by remaining fully engaged in monitoring our performance and providing challenge. We will continue to apply our established governance to monitor performance commitments regularly at the Executive Committee and Board, and at Disclosure Committee and Audit Committee at mid-year and year-end points in the reporting cycle. Our governance includes the reporting of our wastewater performance commitments following the establishment of Hafren Dyfrdwy and the inclusion of a wastewater licence."	No intervention required.  The Board of Hafren Dyfrdwy provides a compliant assurance statement.	N/A

HDD.CA.A2	Required	On gearing benefits sharing the company's explanation of its sharing mechanism is too high-level to assure that it provides benefits to customer's equivalent to our default mechanism. It should incorporate our 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.	1 April 2019	Hafren Dyfrdwy confirms that it is committed to implementing the default gearing benefit sharing mechanism articulated in the 'Putting the sector in balance' position statement.	No intervention required.  The company satisfactorily addresses the action.	N/A
HDD.CA.A3	Required	On dividend policy the company is required to 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:  clear Board commitment to publish detail on dividend policies in the APR and to signal changes to stakeholders; and  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.  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.	1 April 2019	Hafren Dyfrdwy confirms its commitment to publish its dividend policy in its annual performance report, including how the policy takes account of obligations and commitments to customers, and explanations of any changes to the policy and the judgements the Board has made in making that change. The Board also commits to explain each year how any dividends declared or paid have been determined.  The company states that when considering the dividend, the Board will have regard to its performance across its obligations and outcome delivery incentives.	No intervention but further action needed by Hafren Dyfrdwy.  The company provides sufficient evidence of its intention to meet the expectations on dividends as set out in 'Putting the sector in balance' position statement but its response lacks detail on how it will demonstrate annually to stakeholders that it has met them. It provides insufficient transparency as to:  the specific obligations and commitments to customers; the level of performance delivery they will be considered against; and how they will impact on dividends.	We expect the company to be transparent about how the dividend policy in 2020-25 takes account of obligations and commitments to customers and to demonstrate that in paying or declaring dividends it has taken account of the factors we set out in our 'Putting the sector in balance' position statement. We expect the company to respond to this issue in its response to our draft determination.  We expect the company to demonstrate that its dividend policy for 2020-25 takes account of obligations and commitments to customers and other stakeholders, including performance in delivery against the final determination. In doing so, the company should refer to the examples of best practice we have identified among companies.
HDD.CA.A4	Required	On executive pay the company is required to 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:  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 remuneration to delivery to customers;	1 April 2019	In addition to the initial assessment of plans response Hafren Dyfrdwy has provided further information on its proposed policy for 2020-25.  Hafren Dyfrdwy confirms its commitment to aligning to the expectations of 'Putting the sector in balance' position statement. The company states that as part of the Severn Trent Group of companies it is part of a unified remuneration structure, in which the executive performance related pay consists of:  Annual bonus based on 51% customer & environment (8% colleague safety, 8% complaints, 15% customer outcomes (ODI's), 10%	No intervention but further action needed by Hafren Dyfrdwy.  Hafren Dyfrdwy's proposed policy demonstrates the company's commitment to move in the direction of the expectations set out in 'Putting the sector in balance' position statement.  We understand that the policy will apply at the group level, taking account of the company's position within the group. The company has	There remain some details to be finalised, for example details of the underlying metrics that the company is proposing to use in the annual bonus and how they will deliver stretching performance.  Once finalised we expect Hafren Dyfrdwy to provide an update in its response to the draft determination to demonstrate that it is committed to meet the expectations we have set out in 'Putting the sector in balance'

		<p>clear explanation of stretching targets and how they will be applied;</p> <p>clear explanation of how the policy will be rigorously applied and monitored; and</p> <p>commitment to report how changes, including the underlying reasons, are signalled to customers.</p> <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>asset health and 10 % environment and social outcomes (ODI's)) and 49% PBIT.</p> <p>The remuneration committee approve the awards before any payment is made, and has the discretion not to award a payment should it believe there is a reason to do so.</p> <p>Following further correspondence the company has removed the long term incentive component from the policy, as it states that the design of the scheme is more suited to FSTE 100 companies rather than small companies like Hafren Dyfrdwy.</p> <p>Hafren Dyfrdwy states it will continue to publish full details of targets, achievement against them and performance narrative in the directors' remuneration report and is committed to engage with shareholders regarding any proposed changes to the design or performance metrics.</p>	<p>confirmed that Hafren Dyfrdwy customers would only contribute to any bonus payments if performance targets for Hafren Dyfrdwy are met and has confirmed that the remuneration committee has full discretion not to award a payment. We expect the company to demonstrate to customers how it will ensure its policy will align with the customer interest in both the short and the long term.</p>	<p>position statement. In addition, we expect the company to demonstrate how the policy and its implementation maintains alignment with the service delivered to the customers of Hafren Dyfrdwy in the short and the long term.</p> <p>We expect the company and its remuneration committee to ensure its performance related executive pay policy demonstrates a substantial link to performance delivery for customers through 2020-25 and is underpinned by targets that are stretching. Trust and confidence can best be maintained where stretching performance is set by reference to the final determination and taking account of stretching regulatory benchmarks (for example delivery of upper quartile performance) and should include a commitment that it will continually assess performance targets to ensure targets will continue to be stretching throughout 2020-25.</p> <p>We expect the company to report transparently, in its annual performance report, about further updates to the development of its policy that will apply in 2020-25.</p>
HDD.CA.A5	Required	The company is required to provide further information on which PR14 performance commitments it has discontinued.	1 April 2019	Hafren Dyfrdwy provides sufficient information on which PR14 performance commitments it has discontinued and the reasons why.	<p>No intervention required.</p> <p>Hafren Dyfrdwy satisfactorily addresses the action.</p>	N/A
HDD.CA.A6	Required	Provide a revised financial model (based on version 16z released on 31 January 2019) and data tables on 1 April 2019.	1 April 2019	Hafren Dyfrdwy provides a revised financial model based on version 17z (as communicated to companies since the initial assessment of plans action was set) and data tables.	<p>No intervention required.</p> <p>Hafren Dyfrdwy satisfactorily addresses the action.</p>	N/A
HDD.CA.A7	Required	In App1, provide forecast data for supply interruptions in analogue format to align with the commentary, ie HH:MM:SS rather than decimal minutes.	1 April 2019	Hafren Dyfrdwy's provides forecast data for supply interruptions in analogue format.	<p>No intervention required.</p> <p>Hafren Dyfrdwy satisfactorily addresses the action.</p>	N/A
HDD.CA.A8	Required	The company should explain the assurance process it has taken to develop its tax forecasts to demonstrate that accounts forecast	1 April 2019	Hafren Dyfrdwy provides a letter of assurance which summarises the scope of the assurance work performed on tax. It confirms that	No intervention required.	N/A

			<p>for tax take account of customer interests, in particular to clarify the scope of the assurance of the work that was undertaken and the outcome of that work.</p> <p>Additionally, the company proposes a net margin of 1.20 % for &lt; 5 MI/d users despite operating in a non-contested market segment. It should limit its margin to the PR16 1.00 % cap, or provide compelling evidence why this is not appropriate.</p>		<p>judgements, assumptions and methodology were considered and confirmed to be reasonable.</p> <p>Please refer to HDD.RR.A1 for details of the company's response to the second part of this action and our assessment and rationale.</p>	<p>Hafren Dyfrdwy satisfactorily addresses the action.</p>	
	HDD.CA.B1	Advised	<p>Provide updated financial model (based on version 16z released on 31 January 2019) that addresses the following:</p> <ul style="list-style-type: none"> <li>- Differences in pension charges for all controls between the financial model and the business plan tables.</li> <li>- Differences in fixed asset costs and depreciation between the business plan tables and financial model for wholesale water network plus; and</li> <li>- In App14, 'Trade and other payables' have been completed using the correct signage and liabilities which have been entered as a positive instead of a negative figure. Notional dividend yield and growth rates have also been populated using the appointee cost of equity instead of the wholesale cost of equity.</li> </ul>	1 April 2019	<p>Hafren Dyfrdwy provides a financial model based on version 17z (as communicated to companies since the initial assessment of plans action was set) and data tables which contain consistent information for pension charges.</p> <p>Figures for trade and other payables and notional dividend yield and growth rates are also populated correctly. However, the inconsistency between the financial model and business plan tables remain for fixed asset costs and depreciation for wholesale water network plus.</p>	<p>Intervention required.</p> <p>Hafren Dyfrdwy does not provide consistent information in its financial model and business plan tables for fixed asset costs and depreciation for wholesale water network plus.</p>	<p>We are intervening to populate Hafren Dyfrdwy's financial model using figures from its business plan tables.</p>

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

Intervention reference	Our assessment and rationale	Interventions
N/A	N/A	N/A

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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