

July 2019

Trust in water

# PR19 draft determinations

**Affinity Water – Securing confidence and assurance actions and interventions**

## PR19 Draft Determinations: Affinity Water – 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 ‘AFW’ denotes the company Affinity Water. 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 ‘AFW’ denotes the company Affinity Water. 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 Affinity Water draft determination, please see the [draft determinations webpage](#).

**Table 1 – Affinity Water’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	AFW.CA.A1	Required	Provide restated Board assurance that large investment proposals are robust and deliverable, that a proper assessment of options has taken place, and that the option proposed is the best one for customers. The Board’s original statement did not confirm that the large investment proposals are robust.	1 April 2019	Affinity Water’s Board provides the following updated board assurance statement: “Taking all of these matters into account, we can provide assurance that our large investment proposals for AMP7 are robust and deliverable, that a proper assessment of options has taken place, and that the option proposed is the best one for customers”	No intervention required.  The Board of Affinity Water provides a compliant assurance statement.	N/A
	AFW.CA.A2	Required	On dividend policy the company is required to confirm/explain the statement in their plan that annual dividends are not to exceed 5%, as our calculations have resulted in yield figures above 5% in some years (noting that on average yield is below 5%). Please provide an update on the steps you are taking to fully meet the	1 April 2019	Affinity Water confirms it has amended its proposed dividend policy to clarify that base dividends can exceed a nominal 5% yield in a year, as long as an average nominal 5% yield over the AMP is not exceeded. It also reduced dividends in its revised plan, so that the base yield is below 5% in all years of AMP7.	No intervention but further action needed by Affinity Water.	We expect the company to be clear about how it will take account of the particular risks to its long term financial resilience, set out in the securing long-term resilience actions and interventions tracker.  We expect Affinity Water to demonstrate that its dividend policy for 2020-25 takes account of obligations

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
			expectations as set out in our putting the sector in balance position statement.		The company's proposed dividend policy considers its performance in the round against the targets set on its customer performance and business plan.		and commitments to customers and other stakeholders, including performance in delivery against the final determination. We expect the company to respond to these issues in its response to our draft determination.
	AFW.CA.A3	Required	<p>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:</p> <p>Clear explanation of stretching targets and how they will be applied.</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>	1 April 2019	<p>Affinity Water states that it is committed to meet the expectations set out in our 'Putting the sector in balance' position statement.</p> <p>The company states that targets are aligned to the commitments made for AMP7 and have been informed by customer engagement and challenged by their customer challenge group.</p> <p>Affinity Water has committed to publishing a separate annual report on remuneration, with the first report being published in July 2019, which will also incorporate and changes to the policy and the underlying reasons for the change.</p>	<p>No intervention but further action needed by Affinity Water.</p> <p>Affinity Water'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.</p>	<p>There remain some details to be finalised, for example details of the weightings of the underlying metrics in the annual and long term bonus schemes. Once finalised, we expect Affinity Water 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' position statement.</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>
	AFW.CA.A4	Required	Provide a revised financial model (based on version 16z released on 31 January 2019) and data tables on 1 April 2019 that: a) uses the Ofwat model; b) addresses the material inaccuracies in financial ratios based on the actual company structure; and c) ensures consistency of allowed revenues.	1 April 2019	Affinity Water 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. The company has satisfactorily addressed the material inaccuracies in financial ratios and allowed revenues in the financial model are now consistent with the data tables.	<p>No intervention required.</p> <p>Affinity Water provides a satisfactory response to this action.</p>	N/A

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
	AFW.CA.A5	Required	<p>The company should revise its business plan and associated financial modelling to be based on our 'early view' of long term CPIH of 2.0% and RPI of 3.0%, or provide compelling evidence why this is not appropriate.</p> <p>The company should obtain third party assurance that the actual and notional financial ratios are consistent with the Ofwat PR19 financial model and in the case of the notional ratios, are based on the notional company assumptions as set out in the methodology.</p>	1 April 2019	<p>Please refer to AFW.RR.A1 for details of the company's response to the component of the action on inflation and our assessment and rationale.</p> <p>The company provides third party assurance that the actual and notional financial ratios are consistent with the Ofwat PR19 financial model and in the case of the notional ratios, are based on the notional company assumptions as set out in the methodology. We note that both external assurance providers identified issues with the process for completing the data tables, which although not material to our assessment of financeability, does raise some concerns over the internal assurance process. We expect Affinity Water to have appropriate internal assurance processes in place.</p>	No intervention required.	N/A
	AFW.CA.A6	Required	<p>Provide revised tables Wr6 and Wr7 that reconcile and address the following issues:</p> <ul style="list-style-type: none"> <li>- The benefit from the Sundon treatment should not appear as a post 2020 capacity increase because the company is already entitled to this water resource and the current constraining issue is the treatment of the water. Therefore it does not represent an increase in water resources capacity.</li> <li>- Identified benefits appear to be included from 2020-21 onwards in Wr6 and this does not reconcile with the dates for delivery of benefit as shown in table Wr7. The benefits identified under the zone titles in Wr7 appear to be associated with different zones in Wr6. The company has provided a range of asset lives but the 5 year asset life for a building is unexpectedly low.</li> <li>- The company does not follow the definition of bilateral entry capacity and confuses it with bilateral trades. The company has explained that it has assumed third party and neighbouring water company trades should be recorded in bilateral capacity. These are not bilateral entrants and therefore should be removed from this line and included in the company post 2020 capacity lines if they represent new trades or increases of existing trades and in the pre-2020 capacity line if they are associated with the capacity from renewal of an existing trade.</li> </ul>	1 April 2019	<p>Affinity Water:</p> <ul style="list-style-type: none"> <li>- Populates Table Wr6 and provides associated commentary to confirm that the benefits of Sundon treatment are now correctly omitted.</li> <li>- Reconciles the benefits and zone titles in Wr6 and Wr7 and removes building asset lives.</li> <li>- Removes bilateral entry capacity for future years in table Wr6.</li> </ul>	<p>No interventions required.</p> <p>Affinity Water provides a satisfactory response to this action.</p>	N/A

**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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