

July 2019

Trust in water

PR19 draft determinations

Wessex Water – Securing confidence and assurance actions and interventions

PR19 Draft Determinations: Wessex 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 'WSX' denotes the company Wessex 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 'WSX' denotes the company Wessex 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 Wessex Water draft determination, please see the [draft determinations webpage](#).

Table 1 – Wessex 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	WSX.CA.A1	Required	Provide restated Board assurance that the business plan will enable the company to meet its statutory and licence obligations, now and in the future and take account of the UK and Welsh Government's strategic policy statements. The Board's original statement does not make reference to its licence obligations or UK strategic policy statement.	1 April 2019	Wessex Water's Board provides the following updated Board statement: "The Board assures: that the submission is a high-quality and deliverable plan, that it is consistent with, and will allow the company to deliver against both its current licence conditions and its strategic policy obligations now and up to 2025 and takes account of the Government's Strategic Priorities and Objectives for Ofwat."	No intervention required. The Board of Wessex Water provides a compliant assurance statement.	N/A
	WSX.CA.A2	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 does not confirm that a proper assessment of options has taken	1 April 2019	Wessex Water's Board provides the following updated Board statement: "The Board assures: that the expenditure projections contained within this business plan are robust and efficient, and that in particular for large investments a proper assessment of options has taken place and the options chosen are deliverable and best for customers."	No intervention required. The Board of Wessex Water provides a compliant assurance statement.	N/A

			place and that the chosen large investments are the best for customers.				
WSX.CA.A3	Required	Provide restated Board assurance that the Board's governance and assurance processes will deliver operational, financial and corporate resilience over the next control period and the long term. The Board's original statement refers to the company's ongoing governance processes rather than its own governance processes as required in the methodology. Also, the statement does not refer to resilience over the next control period and long-term.	1 April 2019	Wessex Water's Board provides the following updated Board statement: "The Board assures: that the Board's ongoing governance processes are fit for purpose and will enable us to monitor and hold company management to account for the delivery of this business plan (and the performance commitments therein) and delivering operational, financial and corporate resilience over the next control period and the long term."	No intervention required. The Board of Wessex Water provides a compliant assurance statement.	N/A	
WSX.CA.A4	Required	Provide Board assurance that the Board will monitor delivery of its outcomes to ensure they meet its relevant statutory and licence obligations. We found no evidence of a Board assurance statement in the company's original submission.	1 April 2019	Wessex Water's Board provides the following new Board statement: "The Board assures: that the board's ongoing governance processes are fit for purpose and will enable us to monitor and hold company management to account for the delivery of this business plan (and the performance commitments therein) and delivering operational, financial and corporate resilience over the next control period and the long term."	No intervention required. The Board of Wessex Water provides a compliant assurance statement.	N/A	
WSX.CA.A5	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: position statement' to include: <ul style="list-style-type: none"> 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	Wessex Water confirms that it is committed to adopting all of the expectations on dividends as set out in 'putting the sector in balance: position statement'. It confirms that before approving each quarterly dividend, the Board will take into account the current and projected performance in delivering the level of service customers expect. The company has committed to report annually how the above factors have been taken into account when determining the level of dividend. The company states that if the board agrees changes to its dividend policy these will be published with reasons in the Annual Review.	No intervention but further action needed by Wessex Water. 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: <ul style="list-style-type: none"> 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 Wessex Water 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 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.	

WSX.CA.A6	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: position statement' to include:</p> <ul style="list-style-type: none"> - visibility and evidence of substantial linkage of executive remuneration to delivery to customers; - clear explanation of stretching targets and how they will be applied; - clearer explanation of how the policy will be rigorously applied and monitored; - commitment to report how changes, including the underlying reasons, are signalled to customers; and - commitment to publish the executive pay policy for 2020-25 once it has been finalised. <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>Wessex Water states that its proposals for executive performance related pay are in line with the expectations set out in 'putting the sector in balance: position statement', details of which are;</p> <ul style="list-style-type: none"> • annual bonus based on 30% customer and 30% environment (2 baskets of measures including leakage, C-Mex, pollutions, sewer flooding, water quality and proportion of PR19 targets met), 20% employee (including staff engagement, training, turnover and health & safety) and 20% personal objectives. • long term bonus which withholds a proportion for eligible annual bonus until the end of the 5 year regulatory period. • each year the remuneration committee will set stretching targets having regard to historical company performance, sector performance and the performance commitments in the business plan, although also commenting that a final determination is not a business plan, it must always be for companies to develop and own their business plans rather than a regulator. • each year, the remuneration committee will review the overall performance and only if three quarters or more of the customer and environmental targets have been achieved will directors be eligible for an award. • annual reporting on how the company has met the guiding principles of the policy, and the reporting of any changes that have been made and the reasoning for the changes. <p>The company states the remuneration committee will approve an updated executive performance related pay policy for 2020 during this year.</p>	<p>No intervention but further action needed by Wessex Water.</p> <p>The company'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 underlying metrics and associated weightings in the annual bonus. Once finalised, we expect Wessex 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>
WSX.CA.A7	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	Wessex Water provides a revised financial model based on version 17z (as communicated to companies since the initial	No intervention required.	N/A

					assessment of plans action was set) and data tables.	Wessex Water provides a satisfactory response to this action.	
WSX.CA.A8	Required	<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> <p>The company should revise its business plan and associated financial modelling to be based on our 'early view' of cost of capital, or provide compelling evidence why this is not appropriate.</p>	1 April 2019	<p>Wessex Water confirms that it commissioned third party assurance on the consistency of ratios with the Ofwat PR19 financial model. The company states that based on the outcome of this third party assurance, its audit and risk committee recommended to the Board of Wessex Water that it could make the updated assurance statement.</p> <p>Please refer to WSX.RR.A1 for details of Wessex Water's response to the second part of this action and our assessment and rationale.</p>	<p>No intervention required.</p> <p>Wessex Water provides satisfactory responses to these actions.</p>	N/A	
WSX.CA.B1	Advised	<p>The company should provide an updated financial model that:</p> <p>a) corrects for inconsistencies with its business plan tables in relation to several run off rate inputs, most significantly 'RCV run off rate ~ CPI/CPI(H) linked RCV' and</p> <p>b) is notionalised in accordance with Ofwat guidance e.g. the interest rate on index linked debt has been omitted and the company has also not provided a notional cost of debt override, resulting in a materially higher revenue allowance for tax</p> <p>c) includes notional overrides for the Cost of Equity or Cost of Debt.</p>	1 April 2019	<p>Wessex Water confirms that its revised financial model is notionalised in accordance with Ofwat guidance and that inconsistencies between the model and the data tables have been corrected.</p>	<p>Intervention required.</p> <p>Some minor inconsistencies still exist between business plan tables and the financial model e.g. water and wastewater network RCV, trade receivables / payables, capex creditor days.</p> <p>We confirm that notionalisation is now consistent with our guidance but combined dividend yield and growth of 4.52% is below our early view of the real (CPIH based) cost of equity.</p>	We are intervening to use our view of dividend yield and growth and basing RCV and other inputs from Wessex Water's business plan data tables and feeder models.	
WSX.CA.B2	Advised	<p>Provide water trading values in table App26 and comment on the differences to the App26 calculated by the third party consultant. The values used by the third party for their model incorporates the base numbers from the company's calculations but for revenue there is a skewed set of numbers after the first two years which are similar to WSX's figures.</p> <p>The company should ensure consistency between the financial model and table App10 (notional or actual figures) for the following items and set out the basis of the data provided within the tables:</p> <ul style="list-style-type: none"> - Gearing - Interest cover - ACIC and ACIC (alternative) - FFO/Net Debt and FFO/Net debt:alternative 	1 April 2019	<p>Wessex Water's resubmission uses a consistent approach for completion of App26 and presentation of RoRE information in the plan documentation. This adequately addresses the advised actions.</p> <p>The company provides sufficient evidence that there is consistency between the financial model and data table App10 for the items identified in the initial assessment of plans action.</p>	<p>No intervention required.</p> <p>Wessex Water provides satisfactory responses to these actions.</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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