

8 January 2019

Regulatory Ring-fencing  
Ofwat  
Centre City Tower  
7 Hill Street  
Birmingham  
B5 4UA

Sent by email only to: [FinanceAndGovernance@ofwat.gsi.gov.uk](mailto:FinanceAndGovernance@ofwat.gsi.gov.uk)

Dear Sir/Madam,

### Consultation on strengthening the regulatory ring-fencing framework

Thank you for the opportunity to respond to the consultation on strengthening the regulatory ring-fencing framework.

Dŵr Cymru Welsh Water's response to the consultation questions is set out below.

**1) In light of the summary of views expressed and our initial consideration of the points made to date, do you agree with, or have any further comments to make with respect to, the proposal that all Appointees' licences require that they "must ensure" they maintain an appropriate investment grade credit rating at all times? (See Annex: Condition P7) Do you think that this would give rise to any particular issues of a practical nature? If so, please explain and provide evidence of these impacts.**

We agree that the proposal to strengthen licence conditions to require Appointees to ensure they maintain an investment grade credit rating is in the best interests of customers and companies. Indeed it is a de-facto requirement of our current financing arrangements which are more stringent than our current licence provision. Maintaining an investment grade credit rating is an important tool in ensuring that the company is able to raise debt at an efficient cost.

We stress test our financial plans and take into account factors which could result in the company's inability to maintain an investment grade credit rating and identify mitigating actions the company might take to maintain financial resilience. Despite these mitigating actions we note that there is a residual risk that circumstances beyond a company's control may lead to rating downgrade. We welcome the acknowledgement that such circumstances can be taken into account of in Ofwat's reaction to any such breach.

**2) Do you agree with the proposal to adjust the definition of issuer credit rating to explicitly allow for the use of a corporate family rating? (See Annex: Condition P7)**

We welcome the proposed revision to the definition of issuer credit rating.

In practical terms, in satisfying the existing requirement to use all reasonable endeavours to ensure that the Appointee or any associated company that issues corporate debt on its behalf, maintain an investment grade credit rating, we rely (in addition to the Corporate Family rating issued by Moody's) upon the rating of our senior debt by S&P and Fitch as opposed to an Issuer Credit Rating. We would welcome confirmation that the proposed changes are not intended to change the arrangements already in place and widening of the definition to specifically acknowledge the senior debt rating as a suitable alternative to an issuer credit rating.

**3) Do you agree with, or have any further comments to make with respect to, the proposal to include the most up-to-date cash lock-up provisions for companies where they are currently not included? (See Annex: Condition P7)**

We do not disagree with the proposal to introduce a cash lock-up provision into our licence. Whilst our licence does not currently contain such a provision we do however draw attention to the fact that the details of our whole business securitisation already include a similar provision which restricts dividend payments in the event of the credit rating of our bonds falling below trigger thresholds.

However, as currently drafted Condition P7.4 (c) isn't applicable to our financing structure. Dŵr Cymru Financing Limited (DCFL) is an associated company of the Appointee and not a wholly owned subsidiary. DCFL exists solely to raise finance on behalf of the appointee. 100% of the debt raised by DCFL is on lent via an intercompany loan to Dŵr Cymru Cyfyngedig (DCC). We appreciate the reassurance given in the call on 14 December 2018 that on this basis DCFL would be considered a permitted exception to the requirement for the financing company to be a subsidiary of the regulated company and would be considered a "Financing Subsidiary" by Ofwat.

**4) What are your views on the changes we have set out to bring the provisions relating to ring-fencing certificates into line with industry-leading standards? (See Annex: Condition P9)**

We welcome the proposed changes to standardise the ring-fencing certificate provisions across the industry.

**5) Do you have any views about the form and consistency of information provided with ring-fencing certificates or our expectations in relation to these matters?**

Paragraph 9.1 of proposed Licence Condition P places an obligation to produce a "statement" in our audited accounts about the availability of "sufficient rights and resources other than financial resources".

This is currently a ring fencing obligation under our Licence Condition K. However, Regulatory Accounting Guideline 3.10 lists all the disclosures that are required in the Annual Performance Report. One of these disclosures relate to Licence Condition K statement. This could be considered duplication. We would welcome an update to the related guidance in RAG 3.10 and the Audit Opinion for the Annual Performance Report to avoid any unnecessary duplication and to clarify the requirements.

**6) Do you agree with our proposal to bring all licences up to the same standard in relation to the reporting of material issues, but not to develop guidance? (See Annex: Condition P10)**

Whilst we welcome the proposal to bring all licences up to the same standard in relation to the reporting of material issues, we continue to believe that guidance would assist in avoiding an unnecessary burden for Ofwat if an appointee takes a conservative view of materiality in order to avoid an unintentional licence breach in the reporting of an issue. In particular given our structure we would welcome guidance on the nature of ownership issues that would be deemed material.

**7) Do you have any other comments on the issues discussed above or elsewhere in this consultation that you would like us to consider?**

In 2001, Glas Cymru agreed a package of changes to Welsh Water's Licence, which reinforced the independence of Welsh Water and ensured its assets were "ring fenced" (i.e. that they could not be used for any other purpose). One of the changes was the introduction of Condition F2 (Further strengthening the financial ring fence). Condition F1 relates to Procurement of Services. Several sections of this condition are no longer relevant to our circumstances and we rely upon a side letter from Ofwat which absolves us from much of the requirements of condition F1. We also have an existing Licence Condition P which contains obligations that are bespoke to us concerning undertakings between Glas Cymru Cyfyngedig and Dŵr Cymru (Holdings) Limited. We have also highlighted this duplication in the broader licence simplification project work.

We look forward to engaging with Ofwat in due course on this and the other specific changes proposed to our licence in light of the outcome of this consultation.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'P.P. Evans'.

**Mike Davis**

**Director of Strategy and Regulation**

