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3rd September 2019

By email to: [REDACTED]

Dear Heather

Consultation on draft guidance on Ofwat's approach to granting derogations from the regulatory ring-fencing framework

Thank you for the opportunity to respond to the consultation on granting derogations from the regulatory ring-fencing framework. In your consultation document published on the 23rd July 2019 you stated that you were keen to hear our views on the draft guidance and whether we think there are any other considerations Ofwat should take into account when carrying out an assessment of a request for consent.

We appreciated the offer to have a telephone conference call with you on the 14th August 2019 and also for writing to us separately following this call. This is the response from Dŵr Cymru Welsh Water to Ofwat's consultation.

1. Our views on the draft guidance and conclusions document

We noted the definition of "Issuer Credit Rating" in Ofwat's decision document following the November consultation on strengthening the regulatory ring-fencing framework.

During the telephone conference we explained that we would like Ofwat to monitor all of our credit ratings as they all reflect the regulated business' creditworthiness.

The credit ratings we hold are:

Fitch

Entity: Dŵr Cymru (Financing) Limited
Senior secured LT: A (negative outlook)
Subordinated LT: BBB+ (negative outlook)

Moody's

Issuer: Dŵr Cymru Cyfyngedig
LT Corporate Family Rating: A2 (negative outlook)

Issuer: Dŵr Cymru (Financing) Limited
Underlying Senior Secured, A2 (negative outlook)
Senior Secured, A2 (negative outlook)

Standard and Poor's

Entity: Dŵr Cymru (Financing) Limited
Senior Secured (SPUR): A (negative)
Senior Secured: AA (stable) [Class "A" Bonds issued with a financial guarantee provided by Assured Guaranty Europe plc]
Senior Secured: A (negative) [Class "B" Bonds which do not carry a financial guarantee]
Subordinated: BBB+ [Class "C" bonds none currently outstanding]

Along with the corporate family rating we regard the ratings of the senior secured debt as being reflective of the entity's creditworthiness. We do not currently hold any subordinated debt and have no current plans to do so therefore the senior debt ratings fully reflect the entity's credit risks.

The entities in the corporate group to which Moody's CFR relates including their Companies House numbers are as follows:

- Dŵr Cymru Cyfyngedig ("DCC") registered office no 2366777;
- Dŵr Cymru Financing Ltd ("DCFL") registered office number CR-108127, registered in the Cayman Islands; and
- Dŵr Cymru (Financing) UK Plc ("DCF UK"), registered office number 11949988, registered in England & Wales.

DCFL is in the process of being liquidated and its debt has been transferred to the new financing company DCF UK. At the moment Moody's rates All 3 of these companies, but on liquidation of the Cayman Island company, the CFR ratings will revert to DCC & DCF UK only.

DCC is the regulated business (RegCo). DCFL/DCF UK are the financing companies (FinCo). The CFR rating is assigned to RegCo.

We also discussed with you that it would be very helpful for Ofwat to issue guidance on what corporate developments it would consider material to the creditworthiness issue. For example, we discussed that an issue of subordinated debt would not necessarily be relevant to Ofwat's consideration of creditworthiness, depending on the scale of the issue relevant to existing debt. While we would expect to discuss any change in debt structure with our contact at Ofwat, it would be helpful for Ofwat's guidance to provide some detail on the *de minimis* threshold that should apply to such disclosure, to avoid the potential for inadvertent Licence breaches (or of over-cautious and bureaucratic notification to Ofwat).

Turning to the specific guidance set out in Ofwat's July consultation, it is not clear why the additional justification for arrangements is required, given that the Annual Performance Report contains a Certificate of Adequacy which requires each company to provide assurance that it has adequate resources to continue to have adequate financial, managerial, technical and operational resources available to it. The

requirements of the Certificate of Adequacy would need to be taken into account when considering any change in company structure or other development which might require a derogation from the ring-fencing provisions to be granted.

2. Are there any other considerations Ofwat should take into account when carrying out an assessment of a request for consent?

It would be helpful if Ofwat could provide examples of where arrangements will be deemed to be in the interests of customers – for example, where commercial subsidiaries are working to business plans which envisage distributable profit being applied to reduce bills for customers or to provide additional investment.

As a separate but related matter, when we spoke on 14 August we also discussed the points we raised in response to Ofwat's earlier consultation on ring-fencing, namely:

- Condition F1 - Procurement of services.
- Condition F2 - Restriction on unregulated activity in the appointed business.
- Condition P1(1) and (2) - Identification of ultimate controllers.

You outlined your initial thoughts about the points raised and confirmed that you would take these into consideration in future Licence modifications. In relation to Condition P it was agreed that it would be helpful to expand upon our issues and subsequently we did so through an email sent to Simon Smith on 20 August.

Yours sincerely



Nicola Williams
General Counsel and Company Secretary