

## Requirements and expectations for ring-fencing certificates

This information notice sets out guidance for water and wastewater companies in England and Wales in preparing their Ring-fencing Certificate (“RFC”), also known as the “certificate of adequacy” in some licences (Condition P 9 or Conditions I 13 to I 25) for the 2019-20 financial year and subsequently. The RFC is a certificate stating that in the opinion of the Board of Directors (“the Board”), the company has sufficient resources to enable it to carry out its Regulated Activities, for at least the twelve month period following the date on which the certificate is submitted to Ofwat. The guidance set out in this information notice aims to ensure that all companies apply an appropriate and consistent level of rigour in what they report through their RFCs, and that companies are clear and transparent in the RFC as to how they have reached their conclusion.

Companies are required to publish their RFC annually alongside their annual performance report (“APR”) and to submit it to Ofwat no later than the date on which each water and wastewater company is required to deliver to Ofwat a copy of each set of regulatory accounting statements prepared under Condition F of the licence. Companies are also required to submit a new RFC to Ofwat within 14 days of the Board becoming aware of any material issue that could impact the company’s ability to finance its Regulated Activities. In addition, each company is required to submit a statement of the main factors that have led to the conclusion that resources are sufficient.

Following a review of RFCs that companies published in March 2019 we identified inconsistencies in the format used and the level of detail provided. Insufficient evidence and detail is problematic because it reduces stakeholders’ ability to rely on the RFC for assurance and reduces its usefulness as a tool for monitoring companies.

### Background

The regulatory ring-fencing framework provides an important protection for companies and their customers.

Each company’s regulatory ring-fence consists of licence conditions which place specific obligations on it. These obligations include requirements for the company to produce and submit to Ofwat an annual Auditor-assured

RFC confirming that, in the opinion of the Board it will have available to it sufficient:

- financial resources and facilities;
- management resources and systems of planning and internal control; and
- rights and resources other than financial resources,

to enable it to carry out the Regulated Activities, for at least the twelve month period following the date on which the certificate is submitted to Ofwat. And further, through the

RFC, the company is required to confirm that all contracts between it and any Associated Company include the necessary provisions and requirements in respect of the standard of service to be supplied to the company, to ensure that it is able to carry out the Regulated Activities.

## The approach we expect companies to take

We expect a statement on the RFC confirming that the RFC has been approved by the Board and the date of that approval.

We also expect a brief explanation that the RFC is a licence requirement, what the requirement involves and the nature of any third-party assurance.

### Date of replacement RFCs

If another RFC needs to be issued after the annual RFC has been published or submitted to Ofwat, we expect it to be both submitted to Ofwat and published on the company website with an explanation that the RFC replaces the one in the APR and why the Board considered it necessary to prepare a replacement RFC. The date the Board approved the RFC should be clear. The most recently dated RFC supersedes all previous RFCs.

### Main factors the Board considers

The licence requires a statement of the **main factors** which the Board has taken into account in giving its opinion for the RFC.

We expect the Board to consider a wide-enough range of factors for a reader to take comfort in the fact that the Board has taken a holistic view of the risks the business faces across the different RFC resource criteria. To ensure a broad enough range of main factors have been considered, we expect the RFC to cover the following key areas:

- financial resources and facilities;

- management resources;
- systems of planning and internal control;
- rights and resources other than financial resources;
- contracting; and
- material issues or circumstances.

This list is not exhaustive. Companies can include more categories as appropriate. We then expect a more specific and detailed list of main factors under each key area. As a minimum, we expect all companies to consider the factors set out in the Appendix or state why these are not appropriate.

Each company faces unique challenges. It follows that what is relevant for one company will not necessarily apply to all companies in the same way. Companies should, therefore, also consider other factors specific to them.

We expect the Board to indicate how they have satisfied themselves that the evidence detailed on the RFC is sufficient to enable them to draw a conclusion, for instance, they can signal what procedures they have in place to ensure a robust process has been followed to produce the RFC.

### Quality and range of main factors considered

We expect the RFC to include a concise explanation of each factor considered such that the reader can gain a full understanding of the factors considered in providing the RFC.

We expect the RFC to be forward-looking based on current information and plans.

Overall we expect there to be a clear connection between the statement that resources are sufficient and the evidence given in the main factors; that is, the conclusion that resources are sufficient should be fully backed up by the evidence given on the RFC. For instance, if a company is known

to be facing significant challenges with its business, we expect to see clear explanations to justify why resources are nonetheless sufficient to sustain the business including actions that the company is taking to address those challenges.

If the business has faced significant challenges in the past or if adversities are expected in the future, it is important for the company to include factors covering the activities that they are undertaking to solve or mitigate the issues. Explaining how the Board has taken account of adverse factors helps stakeholders to understand that these adverse events have been considered and the company has sufficient resources to sustain itself for twelve months following submission of the RFC to Ofwat despite the issues.

### **Assurance**

The licence requires the RFC to be accompanied by a report prepared by the company's Auditors and addressed to Ofwat, stating whether they are aware of any inconsistencies between that RFC and either the regulatory accounting statements or any information which the Auditors obtained in the course of their work as the company's Auditors and, if so, what they are.

The RFC should provide a link to the published statement from the auditors.

### **Next steps for Ofwat on RFCs**

We will continue to monitor RFCs that are published in the APRs for 2019-20 and future years and will consider the quality of those RFCs in line with the guidance set out in this information notice.

We may also review our approach to monitoring and assurance in the future to ensure this remains effective and continues to deliver desired outcomes including our duty to further the resilience objective (that is, the ability of companies to cope with, and recover from, disruption and anticipate trends and variability, in order to maintain services for people and protect the natural environment now and in the future).

### **Enquires**

If you have any questions about this information notice, please send them to [FinanceAndGovernance@ofwat.gov.uk](mailto:FinanceAndGovernance@ofwat.gov.uk)

## Appendix

<b>Minimum set of factors that should be considered for RFC:</b>	
<b>Area</b>	<b>Actions</b>
<b>Financial resources and facilities</b>	<ul style="list-style-type: none"> <li>• Financial details, e.g. cash position, financial headroom, refinancing undertaken/ planned;</li> <li>• Performance against Final Determinations (FDs) set at the last price review;</li> <li>• Credit related factors e.g. credit facilities, ratings, compliance with covenants etc.;</li> <li>• Business plans, long-term viability statements, etc.;</li> <li>• Any relevant reports – internal or third-party.</li> </ul>
<b>Management resources</b>	<ul style="list-style-type: none"> <li>• Management skills, experience and relevant qualifications;</li> <li>• Recruitment process, staff engagement;</li> <li>• Succession planning for key management/staff;</li> <li>• Quality of management/staff induction and other training and development;</li> <li>• Process for ensuring diversity of perspectives;</li> <li>• Board or management activities, reports or statements;</li> <li>• Independence of Board.</li> </ul>
<b>Systems of planning and internal control;</b>	<ul style="list-style-type: none"> <li>• Governance procedures; risk management frameworks, oversight procedures;</li> <li>• Internal and/or external audit policies, processes, activities and/or reports;</li> <li>• Systems for maintaining supply / business continuity, stated action plans;</li> <li>• Policies to prevent fraud and other unethical behaviour; whistleblowing policy;</li> <li>• Risk, compliance other assurance statements.</li> </ul>
<b>Rights and resources other than financial resources</b>	<ul style="list-style-type: none"> <li>• Corporate missions and/or values;</li> <li>• Technology and other systems for ensuring checks and balances;</li> <li>• Policies to encourage an integrated approach and ‘systems thinking’;</li> <li>• Planning systems;</li> <li>• Assets maintenance / insurance factors.</li> </ul>
<b>Contracting</b>	<ul style="list-style-type: none"> <li>• Position/status of key contracts in place;</li> <li>• All contracts between the Appointee and all Associated Companies were checked for compliance with licence requirements on standards;</li> <li>• Note on transactions between the Appointee and any Associated Company;</li> <li>• Compliance with licence provision on cross-subsidies between the Appointee and any Associated Company (Condition I); and</li> <li>• No Guarantees or Cross-Default Obligations given without Ofwat’s written consent.</li> </ul>
<b>Material issues or circumstances</b>	<ul style="list-style-type: none"> <li>• Unique to each Appointee</li> </ul>

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.

Ofwat  
Centre City Tower  
7 Hill Street  
Birmingham B5 4UA

Phone: 0121 644 7500  
Fax: 0121 644 7533  
Website: [www.ofwat.gov.uk](http://www.ofwat.gov.uk)  
Email: [mailbox@ofwat.gov.uk](mailto:mailbox@ofwat.gov.uk)

Printed on 75% minimum de-inked post-consumer waste paper  
February 2020

© Crown copyright 2019

This publication is licensed under the terms of the Open Government Licence v3.0 except where otherwise stated. To view this licence, visit [nationalarchives.gov.uk/doc/open-government-licence/version/3](http://nationalarchives.gov.uk/doc/open-government-licence/version/3) or write to the Information Policy Team, The National Archives, Kew, London TW9 4DU, or email [psi@nationalarchives.gsi.gov.uk](mailto:psi@nationalarchives.gsi.gov.uk).

