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6 October 2022

Dear John,

CONSULTATION UNDER SECTIONS 13 AND 12A OF THE WATER INDUSTRY ACT 1991 ON PROPOSED MODIFICATIONS TO STRENGTHEN THE RING-FENCING LICENCE CONDITIONS OF THE LARGEST UNDERTAKERS

At Hafren Dyfrdwy we have a high level of financial resilience, as reflected in our low level of regulatory gearing and a responsible and limited use of financial derivatives. We are delivering improving operational performance for our customers, including one of the best scores on the DWI's water quality compliance risk index (CRI) in 2021.

We agree that water companies should have the financial resilience required to meet customers' needs at all times. We welcome Ofwat's acknowledgement in section 4.1 that the cost of maintaining two credit ratings might be disproportionate for smaller companies. Each credit rating we are required to hold puts almost £3 on to each customer's bill and in our view a second credit rating would not be a good use of our customers' money.

The Hafren Dyfrdwy Board met on 5 October. We understand Ofwat's concerns about financial resilience in the sector and we take comfort that Ofwat's proposals are not aimed at us. However, we are disappointed by extent of the licence modifications Ofwat is proposing and that they will be as painful for Hafren Dyfrdwy as they are for the highly geared companies. We are also not clear what benefits the proposed licence modifications will achieve. That said, our Board accepts Ofwat's licence modifications provided Ofwat guarantees we are only required to hold one issuer credit rating.

Our views on Ofwat's four proposed licence modifications are:

1. **"modify the cash lock-up licence condition to raise the cash lock-up trigger to BBB/Baa2 with negative outlook [i.e. up one notch from now] proposed to take effect from 1 April 2025".**

We accept this licence modification. However, we strongly urge Ofwat to improve the licence condition by allowing companies to request Ofwat not to apply the cash lock up if the credit rating change does not reflect the underlying financial resilience of the company. This would

avoid the cash lock up condition being applied to companies as a result of third parties' decisions, rather than Ofwat's, which might not reflect the specific features of the water sector and its regulation.

2. **“modify the dividend policy licence condition to require that dividend policies and dividends declared or paid should take account of service delivery for customers and the environment over time, current and future investment needs and financial resilience over the long term”.**

We accept this licence modification. We recognise that Ofwat has included the words “over time”, compared with its December discussion paper, in the new licence condition wording. We consider Ofwat should publish its guidance to accompany the licence modification on dividends before Ofwat makes the licence condition modification.

3. **“modify the licence to require companies to hold two issuer credit ratings, or to seek our agreement to an alternative arrangement, if proportionate”.**

We were pleased to see Ofwat welcome Hafren Dyfrdwy's procurement of a credit rating as a positive step in section 4.4 of the consultation.

We welcome Ofwat's acknowledgement in section 4.1 that the cost of maintaining two credit ratings might be disproportionate for smaller companies. Hafren Dyfrdwy is small compared with the rest of the sector - we serve less than 1% of the number of customers that Thames Water does. Due to our size each credit rating we are required to have puts almost £3 on to each customer's bill.

We accept this licence modification, provided Ofwat guarantees we are only required to hold one issuer credit rating.

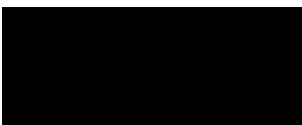
4. **“modify the licence to require companies to notify us about any changes to credit ratings (including changes in rating and/or outlook, new ratings assigned or planned rating withdrawals), with reasons for the change, where applicable”.**

We accept this licence modification, although we note that the requirement to notify within five working days could be extended to ten days to avoid an unintended technical breach of the.

Separately to the proposed licence modifications, Ofwat's consultation mentions that Ofwat will shortly be engaging with companies on updated reporting requirements on swaps and pension liabilities. We support more transparency around swaps and pension liabilities and would be pleased to help Ofwat decide on the right disclosures.

We look forward to working with you constructively on financial resilience.

Yours sincerely,



Helen Miles
Chief Financial Officer

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