



# Strengthening the regulatory ring-fencing arrangements

## 1. Introduction

- 1.1 The Consumer Council for Water (CCWater) is the statutory consumer organisation representing water and sewerage customers in England and Wales. CCWater has four regional committees in England and a committee for Wales.
- 1.2 We welcome the opportunity to respond to Ofwat’s consultation on strengthening companies’ licences to ensure ring-fencing provisions are consistent between companies regardless of ownership structure.

## 2. Executive Summary

- 2.1 In our response to the Ofwat “Change of control - general policy and its application to Thames Water” consultation in June we supported moves to consistently apply ring fencing arrangements so that all customers receive the same level of protection, regardless of the individual ownership structure of the company that serves them.
- 2.2 We therefore support the steps that Ofwat is taking to improve the regulatory regime by reforming companies’ licences. We agree with Ofwat that commonality of protections is important regardless of business model, ownership structure or listing status.
- 2.3 Consistently applied ring fencing arrangements would ensure customers of all companies receive the same level of protection. We also think that consistency will help to improve trust in the sector with all companies being subject to the same set of rules.
- 2.4 We believe that Ofwat’s proposals should go further. Ofwat could provide guidance or the licence could explicitly state what companies are expected to include in their ring-fencing certificates. This would provide a degree of standardisation across the companies. In addition we also see merit in Ofwat either providing guidance on what constitute material issues or a periodic summary of the types of issues/events that have been notified to it.

## 3. Responses to consultation questions

- Q1. 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 with the proposal that all licences require that companies “must ensure” an appropriate investment grade is maintained. As you identify in your consultation, consistency and equivalence between companies’ licences is best achieved with identical licence conditions. That companies have the same conditions in this respect can only help to foster trust and legitimacy in the sector. The “must ensure” condition shows the importance of an investment grade credit rating as an indicator of financial health.

As your consultation alludes to, this change removes any subjectivity that a best or reasonable endeavours’ approach to maintaining an investment grade credit rating has. From a consumer perspective the benefit is the immediacy with which detriment to customers can be prevented, rather than an assessment of whether a company’s actions constitute best or reasonable endeavours.

We recognise that companies’ credit ratings can be affected by the wider economy or events that appear outside of a company’s control. For example, a number of companies’ credit ratings were put on negative outlook following the publication of Back in Balance. It will be important for Ofwat to be

able to discern what are events outside a company's control and the management action in response to that event.

**Q2. 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?**

We agree that it is sensible to adjust the definition of issuer credit rating to include corporate family rating in view that the regulated entity may use other companies within the group to raise finance on their behalf.

We agree that the proposed licence condition should require Ofwat's written approval that the proposed corporate group can be used for the purposes of the investment grade condition.

**Q3. 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?**

In our response to the consultation about Thames we saw benefits in applying consistent standards for cash lock-up provisions. This would ensure customers of all companies receive the same level of protection. In particular we suggested that all companies should have cash-lock up provisions if a company is placed on negative watch by one or more of the credit rating agencies.

As we have noted previously, consistency would help protect customers from any failures as the regulated water company would not be able to release funds to the holding company, without Ofwat's consent, in this scenario.

We note that the wording of 7.3 (c) means the cash-lock up provision applies where the company's rating is the lowest investment grade rating and is on review for downgrade or could be on rating watch/negative outlook.

**Q4. 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?**

As we have already noted, consistently applied ring fencing arrangements would ensure customers of all companies receive the same level of protection. We think that this should also apply to ring-fencing certificates. We outline in response to question 5 that we think that Ofwat should aim for further standardisation of certificates either through guidance or explicit in the licence.

**Q5. 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?**

You note in your consultation that companies have adopted a variety of approaches to the form, substance and level of detail provided in their ring-fencing certificate. However, you are not proposing to use either licence modifications or guidance to try to encourage greater consistency across companies. We think that it would be useful to consider how greater consistency can be achieved.

While we note your expectations for companies to clearly signpost:

- where in their annual performance reports the certificate is;
- the factors the Board has taken into account; and
- their external auditors' reports

we consider that it would be better if this was formalised in companies' licences. In addition we suggest that you consider formalising through the licence a basic suite of information that you expect all companies to include within their certificates. This would help to raise companies to a common standard and strengthen trust people have in the sector.

**Q6. 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?**

We agree that all companies' licences should be brought up to the same standard.

We think that some guidance could be beneficial or at the very least an annual summary of the type of material issues that have been notified to Ofwat. This would reduce the scope for one company to report a particular issue because it regarded it as material whilst another company did not. Companies would retain the responsibility and discretion of reporting against that backdrop.

**Q7. Do you have any other comments on the issues discussed above or elsewhere in this consultation that you would like us to consider?**

We have no further comments.

## **Enquiries**

Enquiries about this consultation response and requests for further information should be addressed to:

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