[redacted] (LGHRRS - Mining Legacy, Water & Flood)

From: [redacted] (LGHCCRA - Land, Nature & Food - Water & Flood)
Sent: 21 November 2024 12:48
To: PS DFM and Cabinet Secretary for Climate Change and Rural Affairs
Cc: Davies, Haf (FMG - Office of the First Minister - Cabinet Division); [redacted] (FMG - Communications - Communications); Fernandes, Clare (LGHCCRA - Land, Nature & Food - Water & Flood); Bennett, Claire (LGHCCRA - Land, Nature & Food - Agriculture, Food & Marine); [redacted] (FMG - Communications - Communications); [redacted] (LGHCCRA - Land, Nature & Food - Water & Flood)
Subject: DFM / Cab Sec Climate Change & Rural Affairs Briefing & Suggested Lines Ofwat Financial Resilience & Performance Related Pay Reports 21 November 2024
Attachments: Protecting customer interests on performance-related executive pay 2023-24 assessment.pdf; Ofwat Monitoring-Financial-Resilience-Report-2023-24 - Copy.pdf

Good afternoon Private Office, further to the email from [redacted] yesterday (see below) this is the briefing on the enclosed reports published by Ofwat today.

1. Protecting customer interests on performance-related executive pay: 2023-24 Ofwat Assessment

Ofwat has published their assessment of how companies have met their expectations for their decisions on performance related executive pay outcomes for 2023-24. Water company executive directors should be incentivised to deliver stretching performance for both customers and the environment, but not rewarded for poor performance. Ofwat's expectations are:

- Alignment to delivery for customers and the environment: the criteria for awarding both the short- and long- term elements of PRP in the year should demonstrate a substantial link to stretching delivery for customers and the environment.
- Stretching targets: award decisions for the year should be based on stretching targets.
- Overall performance: award decisions for the year should take into account overall performance delivered for customers, communities and the environment, and not reward poor performance.

Hafren Dyfrdwy did not report any payments as bonuses were awarded via their parent company. Dŵr Cymru reported an annual bonus of 26% of the maximum, a total of £163k for their Chief Executive and Chief Finance Officers. Ofwat have determined that this was not justified and will using it's recovery mechanism to ensure these are not funded from water bills. The water company will have to fund these from it's existing resources, for example via efficiency measures or limiting future pay increases. Ofwats reasoning was as follows:

Dŵr Cymru was the subject of a provisional enforcement decision from Ofwat which found the company had breached its licence, had a two-star rating (company requiring improvement) in its Natural Resources Wales 2023 performance report and was in the lagging category in Ofwat's 2023-24 Water Company Performance Review. The remuneration committee set out the various factors which it took into account when reaching a decision that it did not need to make an adjustment to the bonus percentage outturn for the year. The percentage of maximum awarded for the annual bonuses was relatively low, at 26%, showing that there was reflection of underperformance in some areas. In addition, there was no long term incentive payment in the year because performance against the measures used did not meet the target required. However, despite the explanation provided and the relatively low proportion of award, Ofwat did not consider that sufficient justification was provided of why any award at all was appropriate in the context of

the events highlighted above. Ofwat will therefore use the recovery mechanism so that Dŵr Cymru will not be able to recover the costs of the payments, which totalled £163,000, for 2023-24.

Lines To Take

- The water companies are an essential public service, funded by water bills. Executive performance payments should only be made to fund exceptional performance and should be robustly regulated.

- We welcome Ofwat's independent scrutiny of water company performance payments and recognise the issues they raise.

- While it is not appropriate for Welsh Government to comment on individual pay awards, we have made clear our expectation that water companies in Wales provide the highest quality service to Welsh consumers, and support Ofwat's close scrutiny and regulation of company performance.

https://www.ofwat.gov.uk/regulated-companies/company-obligations/outcomes/water-company-performance-report-2023-24/

2. Financial Resilience for Water Companies

As part of its regulatory functions Ofwat keeps under review the financial resilience of the water companies. It expects all companies to operate on a sound financial footing with robust and transparent financial arrangements in place. This is to help ensure each company has access to the financial resources it needs, and on reasonable terms, to deliver its functions and investment programmes, to meet its wider obligations, to address underperformance efficiently and to manage risk, volatility or disruption. Ofwat published its annual Monitoring Financial Resilience Report (enclosed) on 21 November 2024.

10 companies are categorised as requiring an increased level of monitoring and/or engagement based on Ofwat's assessment of their financial position, challenges, and in some cases the actions they need to take to address and strengthen their financial resilience, including to ensure they are appropriately financed . Since Ofwat amended the water companies companies' licences in 2023 to declare or pay dividends only in accordance with a dividend policy that takes into account the delivery for customers and the environment and financial resilience over the longer term from 20230- 2024 the value of these overall has fallen. The 2 Welsh companies, Dŵr Cymru and Hafren Dyfrdwy do not pay a dividend.

Ofwat report no concerns with the 2 Welsh companies, Dŵr Cymru and Hafren Dyfrdwy, and no action is required by them at this time. Both companies are subject to ongoing monitoring, including through standard regulatory reporting and engagement.

Dŵr Cymru is rated A3 & A- and Hafren Dyfrdwy is BB+ & Baa1. These are amongst the highest credit ratings given to the water companies, and most companies, including Dwr Cymru are being reviewed by both Agencies with a view a possible downgrade. This could increase the cost of borrowing for the water companies, but Dwr Cymru is expected to remain an investment grade credit rating.

Lines To Take

- Welcome the report as it is important for Ofwat, as the economic regulator to keep water companies finances under review and to challenge them to remain resilient.

- Welcome that Ofwat raise no specific concerns over Haren Dyfrdwy and Welsh Water

- Dŵr Cymru is a not for profit company with no share holders, so instead of paying a dividend to shareholders they provide funding for their social tariffs which help people who are struggling to pay their water bills.

- Most water companies are facing challenging credit ratings, but Hafren Dyfrdwy and Dŵr Cymru are amongst the highest credit rated companies.

https://www.ofwat.gov.uk/wp-content/uploads/2024/11/Monitoring-Financial-Resilience-Report-2023-24.pdf

[redacted]
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Fy nyddiau gwaith yw Dydd Mawrth, Dydd Mercher & Dydd Iau

From: [redacted] (LGHCCRA - Land, Nature & Food - Water & Flood)
Sent: 20 November 2024 19:10
To: PS DFM and Cabinet Secretary for Climate Change and Rural Affairs [redacted]
Cc: Davies, Haf (FMG - Office of the First Minister - Cabinet Division) [redacted]; [redacted] (FMG - Communications - Communications) [redacted]; Fernandes, Clare (LGHCCRA - Land, Nature & Food - Water & Flood) [redacted]; Bennett, Claire (LGHCCRA - Land, Nature & Food - Agriculture, Food & Marine) [redacted]; [redacted] (FMG - Communications - Communications) [redacted]
Subject: OFFICIAL MARKET SENSITIVE Embargoed MFR and PRP reports
Importance: High

Dear PO

Please be advised that the attached market sensitive information, shared with us in confidence, will be released to media by Ofwat tomorrow morning. It includes details of the financial resilience of water companies and of the first operation of Ofwat's performance related pay mechanism: this allows Ofwat to amend, and if necessary reduce, the revenue allowance of water companies to ensure that executive bonuses are not paid for out of consumer bills – in effect reducing chargeable amounts by the equivalent of bonuses that Ofwat deems are not justified because of poor performance.

For ease I have pasted the relevant paragraph for Dwr Cymru below. In context it is a very small figure – 168k across their entire executive pay, where other companies are in the millions. Nonetheless it highlights ofwat's conclusion that DCWW's performance does not justify any PRP for executives. The assessment of DCWW's financial resilience is not a cause for concern. The rating agencies are looking at a potential single rating downgrade but still well within investment grade.

We will provide further briefing and LTT tomorrow.

[redacted]

Dŵr Cymru

Dŵr Cymru was the subject of a provisional enforcement decision from Ofwat which found the company had breached its licence7, had a two-star rating (company requiring improvement) in its Natural Resources Wales 2023 performance report8 and was in the lagging category in our 2023-24 WCPR. The chief executive officer (CEO) and CFO of Dŵr Cymru both received an annual bonus of 26% of the maximum, although there was no LTIP payment because performance in the year did not meet the threshold target.

The remuneration committee set out the various factors which it took into account when reaching a decision that it did not need to make an adjustment to the bonus percentage outturn for the year. The percentage of maximum awarded for the annual bonuses was relatively low, at 26%, showing that there was reflection of underperformance in some areas. In addition, there was no LTIP payment in the year because performance against the measures used did not meet the target required. However, despite the explanation provided and the relatively low proportion of award, we did not consider that sufficient justification was provided of why any award at all was appropriate in the context of the events highlighted above.

We will therefore use the recovery mechanism so that Dŵr Cymru will not be able to recover the costs of the CEO's and CFO's bonus payments, which totalled £163,000, for 2023-24.

From: [redacted]
Sent: 20 November 2024 17:01
To: [redacted] (LGHCCRA - Land, Nature & Food - Water & Flood) [redacted]>; Fernandes, Clare (LGHCCRA - Land, Nature & Food - Water & Flood) [redacted]
Cc: government.engagement [redacted]; [redacted]
Subject: OFFICIAL MARKET SENSITIVE Embargoed MFR and PRP reports

Hi both,

As promised, please see attached our MFR and PRP cost recovery reports. Please note both are embargoed until **7am tomorrow**. David Black will also be sending letters to DFM and MSs tomorrow summarising the outcomes of both reports.

Please note that this contains market sensitive information so if you would like to share these with anyone before tomorrow, please can you send me their names so they can be added to an insider list I am maintaining?

I hope this is helpful but please do let me know if you have any questions.

Kind regards,

[redacted]
Principal, Government Engagement and Strategy | Prif Swyddog, Strategaeth ac ymgysylltu â'r Llywodraeth
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